GLAECONOMICS

London's Economy Today

Issue 192 | August 2018

Bank of England raises interest rates for the second time in a year

By **Emma Christie**, Economist, **Gordon Douglass**, Supervisory Economist and **Mike Hope**, Economist

On 2 August the Bank of England raised the Bank Rate by 25 basis points from 0.5% to 0.75%. This is the highest level this rate has been since March 2009 (see Figure 1), but is still well below the pre-2008 historic low level of 2%.

The Bank raised rates as Consumer Price index (CPI) inflation remains above the Bank's target of 2% with data from the Office for National Statistics (ONS) published on 15 August showing that it stood at 2.5% in July, up from 2.4% in June 2018. It was the first CPI inflation increase since November 2017. Retail Price Index (RPI) inflation, although not targeted by the Bank fell to 3.2% in July, down from 3.4% in June. However, as the July RPI figure is used to set the maximum annual increase for regulated rail fares, this could lead to a big rise in those fares in January 2019.

The Bank commenting on UK inflation observed in its August Inflation Report (published before the July 2018 inflation data was released) that inflation was above target due to "external cost pressures resulting from the effects of sterling's past depreciation and higher energy prices. The contribution of external pressures is projected to ease over the forecast period while the contribution of domestic cost pressures is expected to rise. Taking these influences together, and conditioned on the gently rising path of Bank Rate implied by current market yields, CPI inflation remains slightly above 2% through most of the forecast period, reaching the target in the third year".

Also in this issue

Datastore

The main economic indicators for London are available to download from the London Datastore.

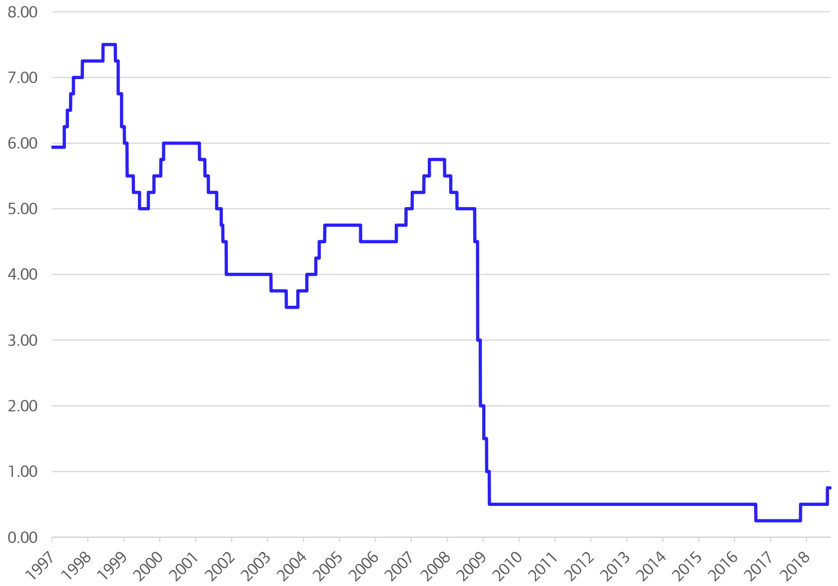


Figure 1: UK interest rates since 1997

Source: Bank of England

In terms of interest rates returning to more historically normal levels the Bank said that the "Bank Rate is likely to remain materially below the 5% level set on average by the [Monetary Policy] Committee (MPC) prior to the crisis" due to structural shifts in desired wealth and demand for capital in the UK. However, they further noted that the "Bank Rate is likely to need to rise gradually as the headwinds to demand recede and the current margin of spare capacity is absorbed". With respect to quantitative easing (QE) the Bank did not change its holdings but did state that the MPC "now intends not to reduce the stock of purchased assets until Bank Rate reaches around 1.5%, compared to the previous guidance of around 2%. Consistent with its previous guidance, a decision to start reducing the stock of purchased assets [i.e. the size of QE] would reflect the economic circumstances at the time".

UK GDP growth ticks up

In terms of the recent economic performance of the UK new data from the ONS published in August showed the UK economy bounced back a bit in the second quarter of 2018, with GDP growing by 0.4% on the previous quarter compared to the 0.2% quarterly growth seen in Q1 2018 (see Figure 2). This was however the sixth consecutive quarter in which the UK economy grew by less than 0.5% quarter on quarter. Looking at the latest quarterly GDP figures in detail the ONS observed that "the services industries and construction increased in Quarter 2 2018, by 0.5% and 0.9% respectively; while production decreased by 0.8%". However, the Business services and finance sector, a particularly important sector to London's economy, only saw a quarterly growth rate of 0.2% during the last quarter with this being down from the 0.5% growth seen in Q1 2018. Also, "the trade deficit widened by £4.7 billion in Quarter 2 2018 (in current price terms), with net trade dragging on GDP growth as a result".

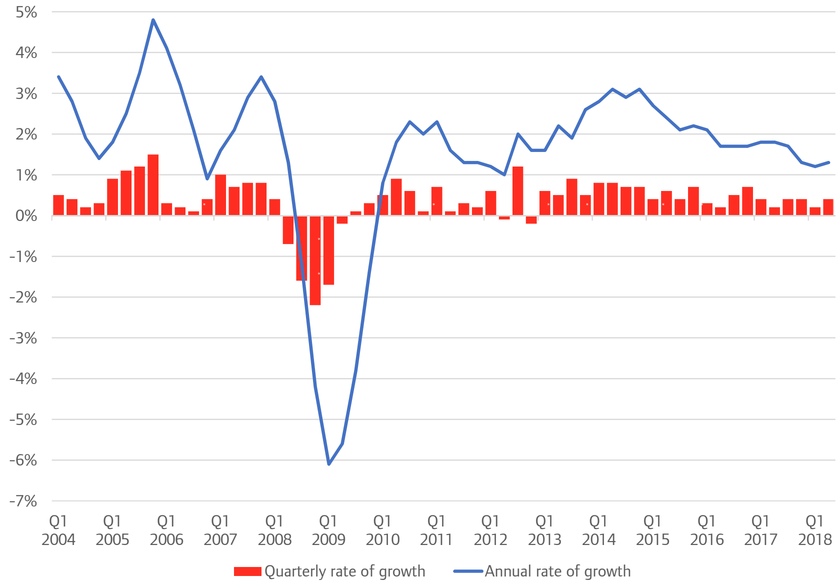


Figure 2: UK GDP Growth

Source: ONS

On an annual basis growth also remained weak with output being 1.3% higher in Q2 2018 compared with Q2 2017, however this is around the current sustainable level of output according to the Bank of England. Thus, the Bank observed in their August Inflation Report that "GDP is expected to grow by around 1¾% per year on average over [their] forecast period". They note that while this is "modest by historical standards, the projected pace of GDP growth over the forecast is slightly faster than the diminished rate of supply growth, which averages around 1½% per year" indicating that interest rates may rise slightly higher than the markets currently expect.

International economic growth continues

Internationally the second quarter of 2018 also saw growth in the economies of a number of important trading partners of the UK. The US economy expanded by an annualised rate of 4.2% in Q2 2018, nearly double the 2.2% annualised growth seen in the previous quarter. Japan avoided entering a technical recession with its economy growing by an annualised rate of 1.9% in Q2 2018, having contracted by 0.9% in Q1 2018. GDP growth also continued in the Eurozone with its economy growing by 0.4% on the previous quarter (on a non annualised rate) in Q2 2018, an unchanged growth rate from Q1 2018. However, trade tensions continue. The US announced further details of its latest trade tariffs on China in August, with 279 products worth roughly $16 billion in imports being targeted for additional tariffs. China in turn announced retaliatory tariffs on US goods worth an equivalent amount. Currency problems have also risen in Turkey on the back of a high current account deficit, high inflation and an ongoing dispute with the US. There are concerns that the falls in the Turkish lira could lead to contagion to other emerging markets, with the possibility of a number of countries' currencies coming under pressure. One such might have been Venezuela, where at the present time problems of hyperinflation have remained largely a domestic matter.

Meanwhile, the UK government has issued a first set of notes for households and businesses on the implications of leaving the EU without a deal, as it steps up contingency planning in the case of such an eventuality. HM Treasury has stated that if this comes to pass it might worsen public finances by £80 billion over a decade.

Better than expected public sector finances

Data published by the ONS in August showed that public sector net borrowing (excluding public sector banks) in the current financial year-to-date (April -July 2018) was £12.8 billion; that is, £8.5 billion less than in the same period in 2017. This is the lowest April -July net borrowing figure since 2002/03. Receipts growth has been above the Office for Budget Responsibility (OBR) full-year forecast, while spending growth has been considerably lower than forecast. Two of the explanations of weak year-on-year growth in departmental current spending, and lower transfers to EU institutions may be affected by timing effects, and so may not continue over a full year. Some of the better than expected finances is likely to be structural, as debt interest payments are lower due to lower than expected RPI inflation earlier in the year.

London's net fiscal surplus increased in 2016/17

On 1 August the ONS published their latest taxation revenue and public expenditure estimates for the nations and regions of the UK. These statistics although "experimental" and thus not classified as national statistics showed that only three areas of the UK raised more in revenues than spending in the tax year 2016/17. These were the East of England, London and the South East. London's net fiscal surplus stood at £32.475 billion, compared to £19.44 billion for the South East and £5.495 billion for the East of England. This compares to a UK net fiscal deficit of £45.677 billion. Commentating on these figures the ONS noted that since 2010/11 "London's net fiscal surplus has been increasing at a greater rate than other" UK nations or regions. With them further observing "the average year-on-year change in London was an increase in its net fiscal surplus of almost £5.0 billion. The smallest average year-on-year change was in Scotland or Northern Ireland, depending on how North Sea revenue was allocated". They also added that "the change in net fiscal balances between FYE [Financial Year Ending] 2016 and FYE 2017 [from a UK deficit of £72.458 billion in FYE 2016 to a deficit of £45.677 billion in FYE 2017] was largely driven by an increase in total revenue of all [UK nations and] regions. However, the increase in revenue in London was larger than the increases in revenues in other" UK nations or regions.

A continued mixed picture in economic indicators for London but most show growth

London's commercial property market saw continued growth in the second quarter of 2018 according to the latest Central London Quarterly report from Knight Frank which was released in August. With it finding that "central London take-up remained robust in Q2 2018, reaching 3.39 m sq ft, which is 7% ahead of the long-term average".

However, looking at the residential property market in the UK the Bank of England in its August Inflation Report observed that "that weakness in the housing market appears to be concentrated in London. In 2018 Q1, mortgage completions for housemovers and first-time buyers in London were around 12% lower than in 2016, and house price and rent inflation have both fallen sharply and are now negative". While it further noted that "although developments in London have tended to lead other areas in the past, if the reasons for the current weakness in London are fairly idiosyncratic, they may indicate little about prospects for the UK housing market as a whole. London house price inflation was particularly strong from 2014–16, reducing affordability. Given its relatively high level of house prices, London was likely to have been disproportionately affected by regulatory and tax changes since 2014. The recent slowing in house prices has brought London more into line with other areas". However, they further added that "some of the weakness in the London market may also reflect a fall in net EU migration, alongside wider Brexit uncertainty. The number of EU nationals in London appears to have fallen slightly since the EU referendum, although it has continued to grow in other regions. As EU nationals make up around 12% of households in London and 20% of the private rental sector, that fall will affect demand for housing services and therefore house prices and rents".

The capital also did not perform well in the latest Economist Intelligence Unit's Global Liveability Index which ranks the most liveable cities in the world and was published in August. In this ranking London came in 48th place ahead of New York (57th) but behind Manchester (36th), Paris (19th) and Vienna which came top.

A survey by the Campaign for Real Ale (Camra) showed the continuing challenges for London's pub trade in the first six months of 2018 with it finding more than 50 pub closures in London during that period. More details on trends in pubs in London is given in the supplement of this publication.

Overall the economic data point to a mixed picture for London's economic performance. While the capital faces a number of challenges, the overall economic trends in London (as shown in the indicators section of this publication) continue to show moderate growth.

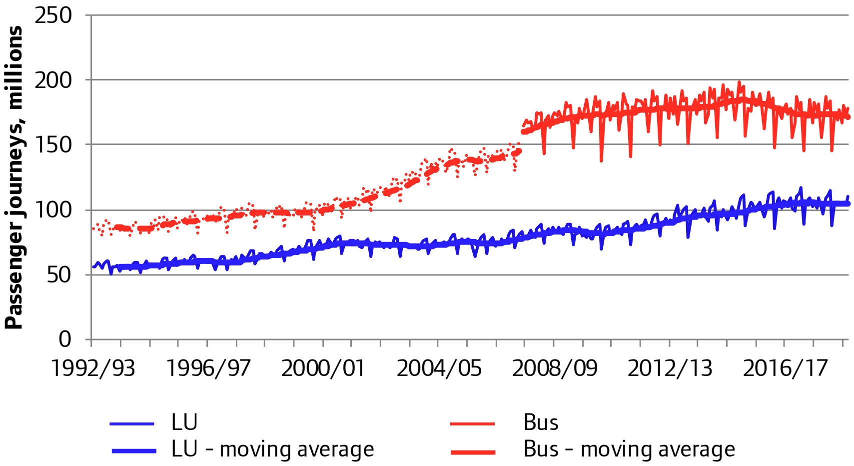
Economic indicators

Continued rise in TfL passenger journeys

- A total of 288.3 million passenger journeys were registered between 24 June and 21 July 2018, 9.1 million more than the previous period accounting for odd days. This is the result of an increase in both bus and Underground journeys. 109.9 million of the total journeys were Underground journeys and 178.5 million were bus journeys.
- The 13-period-moving average in the total number of passenger journeys reduced from 276.6 million to 276.5 million.
- 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).

Source: Transport for London
Latest release: August 2018, Next release: September 2018

Passenger journeys by mode of transport
(adjusted for odd days)

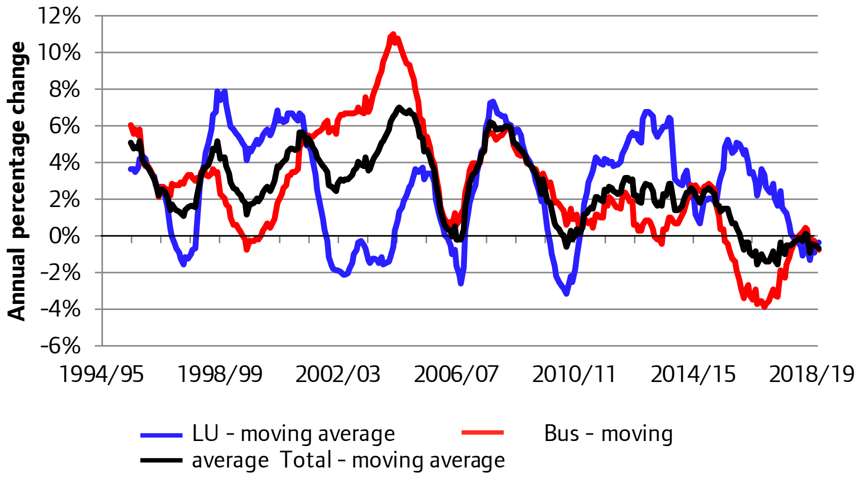


The annual rate in passenger journeys remains negative

- The moving average annual growth rate in the total number of passenger journeys decreased slightly from -0.5% to -0.7%.
- The moving average annual growth rate of bus journeys decreased from -0.5% to -0.8%.
- The moving average of Underground passenger journeys increased from -0.5% to -0.4%.

Source: Transport for London
Latest release: August 2018, Next release: September 2018

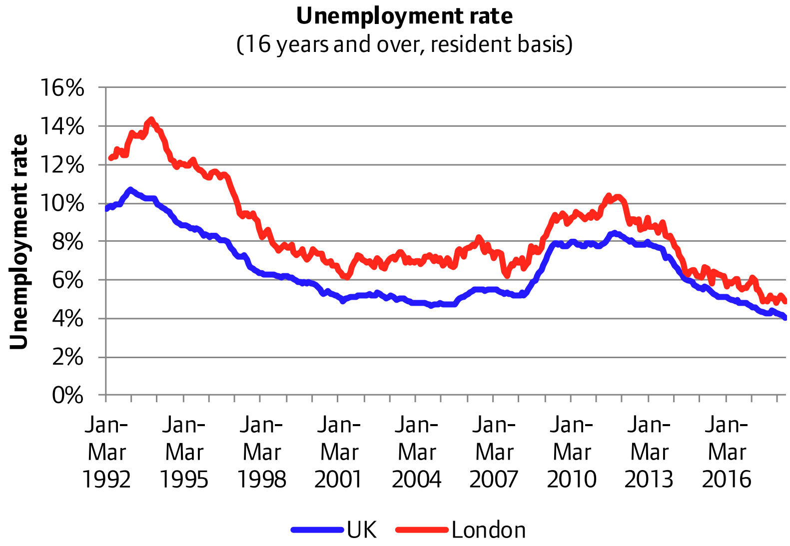
Annual change in passenger journeys by mode of transport
(adjusted for odd days)



London and UK unemployment at historic lows

- 242,000 residents over 16-year-old were unemployed in London for the three-month period April-June 2018.
- The unemployment rate in London returned to the historic low of 4.9% in that period, down from 5.1% in the previous period.
- Meanwhile, the UK's unemployment rate fell to a new low of 4.0%. Unemployment hasn't been this low in the UK since before this data set began in 1992.

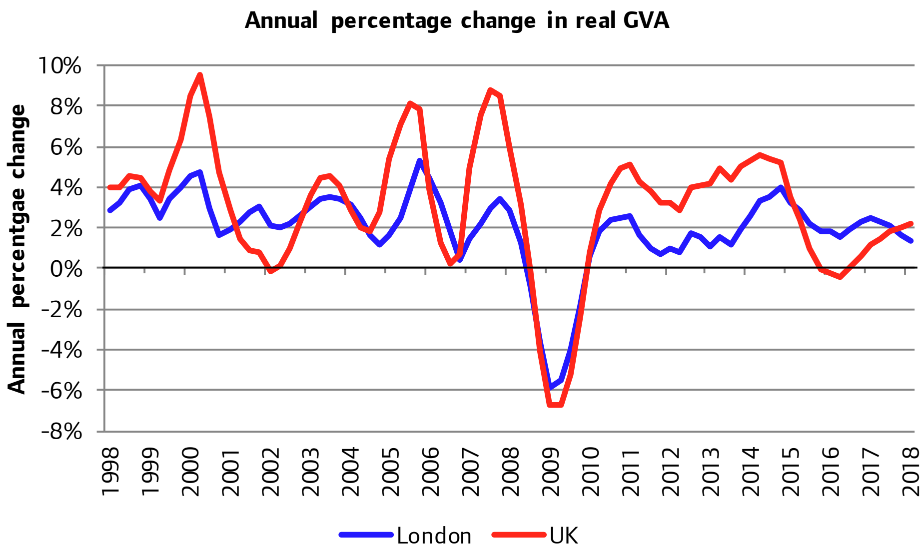
Source: ONS Labour Force Survey
Latest release: August 2018, Next release: September 2018



London's annual output growth reached 2.2% in Q1 2018

- London's annual GVA growth was 2.2% during the first quarter 2018, the highest rate since Q2 2015 and the seventh consecutive increase of the rate.
- In the UK, the downward trend from Q1 2017 continues. Output growth was 1.3% annually in Q1 2018, 0.3 percentage points lower than the previous quarter and representing the weakest expansion in more than 4 years.
- From LET Issue 165 (May 2016), GLA Economics now reports our own GVA estimates for London and ONS data for the UK.

Source: ONS and GLA Economics
Latest release: July 2018, Next release: October 2018

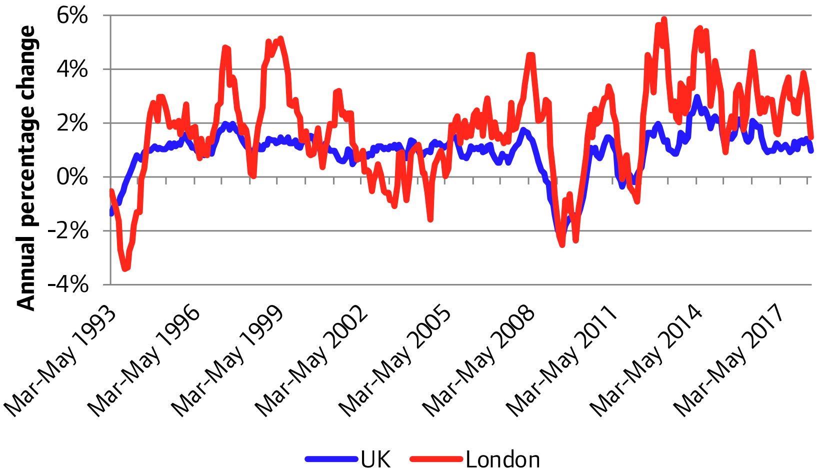


Annual growth in employment in London continues but at a slower pace

- More than 4.71 million residents over 16 years old were employed in London during the three-month period April-June 2018.
- The rate of annual employment growth for the capital fell to 1.5% for this period, 1.8 percentage points slower than registered for the previous period.
- In the April-June 2018 period, the UK employment rate grew annually at a rate of 1.0%, 0.2 percentage points down from the previous period.

Source: ONS Labour Force Survey
Latest release: August 2018, Next release: September 2018

Annual percentage change in employment
(16 years and over, resident basis)

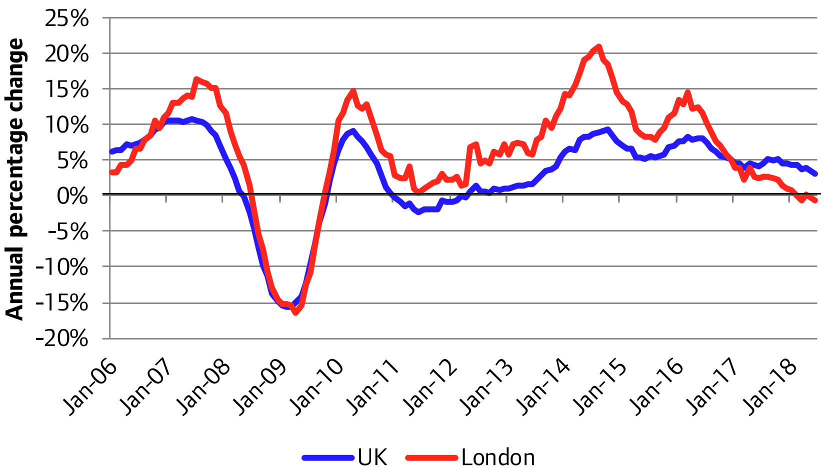


Average house prices in London at lowest level since January 2017

- In June 2018, the average house price in London fell to £475,198, while for the UK the average increased slightly to £225,836.
- The annual growth rate in average house prices in London was -0.7% in June, down from -0.2% in May.
- For the UK, on an annual basis, house prices grew 0.5 percentage points slower in June (3.0% year-on-year) compared to May.

Source: Land Registry and ONS
Latest release: August 2018, Next release: September 2018

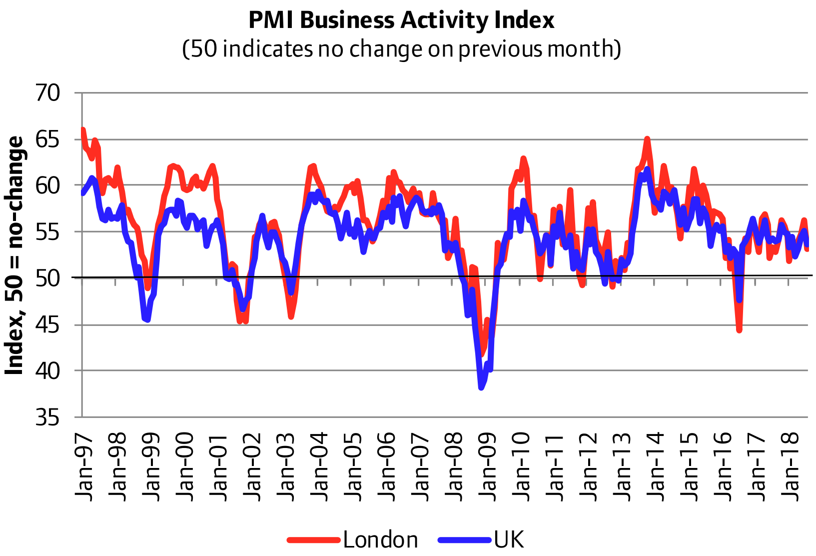
Annual percentage change in average house prices
(seasonally adjusted)



London business activity slows in July

- 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.
- Business activity growth at London private firms was 53.1 in July, down from 56.2 in June.
- The UK index also decreased from 55.2 in June to 53.6 in July

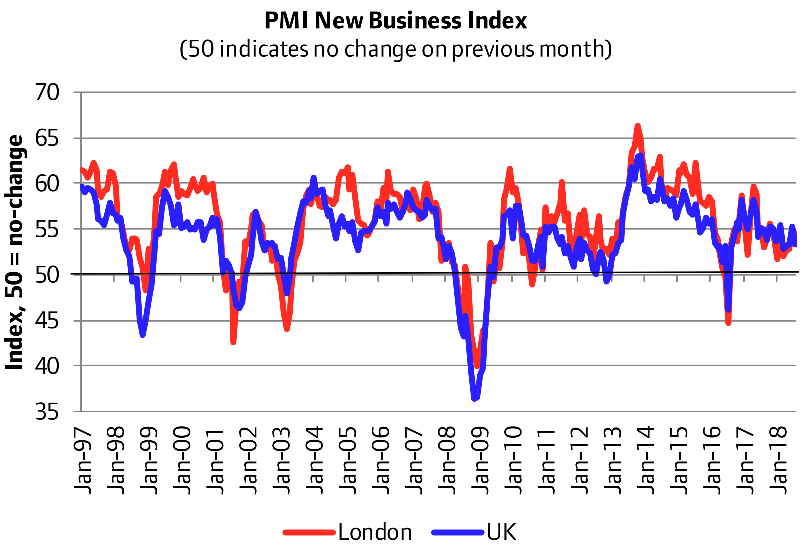
Source: IHS Markit
Latest release: August 2018, Next release: September 2018



Growth in new business remains solid in London

- The PMI New Business Index was 54.2 in London in July, down slightly from the eight months high of 55.0 in June.
- Meanwhile, UK firms reported an index of 53.4 in July, also down compared to the index score of 55.2 seen in June.
- An index reading above 50.0 indicates an increase in new orders from the previous month.

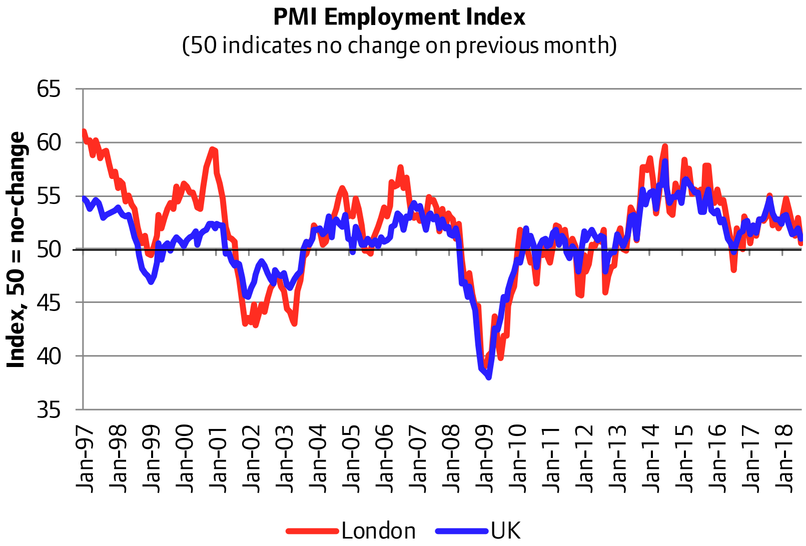
Source: IHS Markit
Latest release: August 2018, Next release: September 2018



Employment growth in London falls to lowest rate since January 2017

- 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.
- The Employment Index for London was 50.6 in July, down from 53.0 in June. While still an increase, this is the lowest index score recorded for London since January 2017.
- Employment levels also increased across the UK in July (51.0) though at a slightly slower rate than the previous month (51.9).

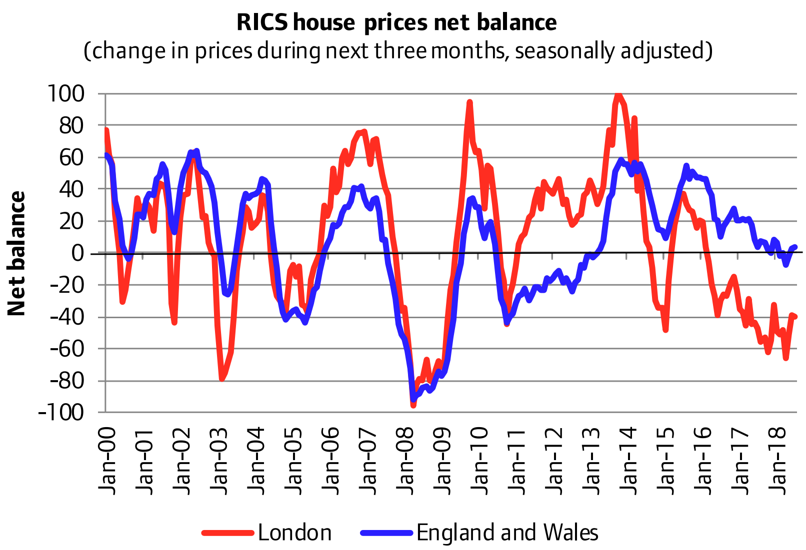
Source: IHS Markit
Latest release: August 2018, Next release: September 2018



Most property surveyors report continued contraction in London house prices

- In the three months to July 2018, the net balance of property surveyors fell from -39 to -40. The index has now been negative since the three-month period to March 2016.
- The RICS house prices net balance index for England and Wales increased from 3 to 4 for the same mentioned period.
- The net balance index measures the proportion of respondents reporting a rise in prices minus those reporting a decline.

Source: Royal Institution of Chartered Surveyors
Latest release: August 2018, Next release: September 2018

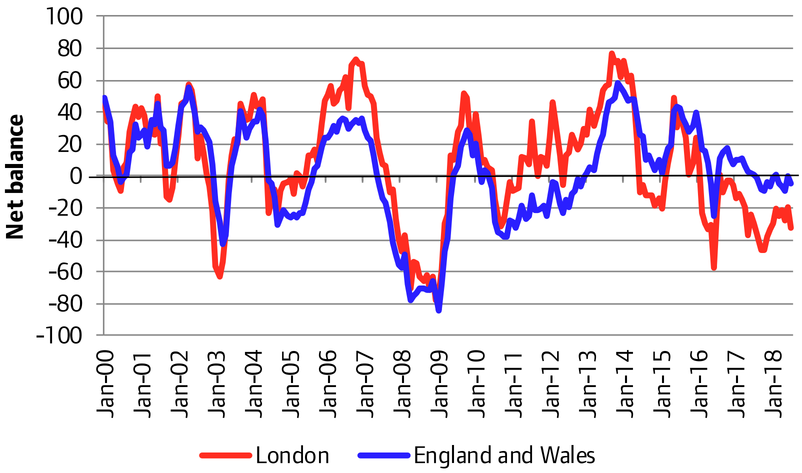


House prices expectations in London fall further in July

- Most surveyors continued to have negative expectations for the next three months for house prices in London. The RICS index was -32 in July, down from -20 in June.
- London remains the region with the most negative expectations for house prices.
- Sentiment in England and Wales was also negative in June (-5) down from 0 in May.

Source: Royal Institution of Chartered Surveyors
Latest release: August 2018, Next release: September 2018

RICS house prices expectations net balance
(change in prices during next three months, seasonally adjusted)

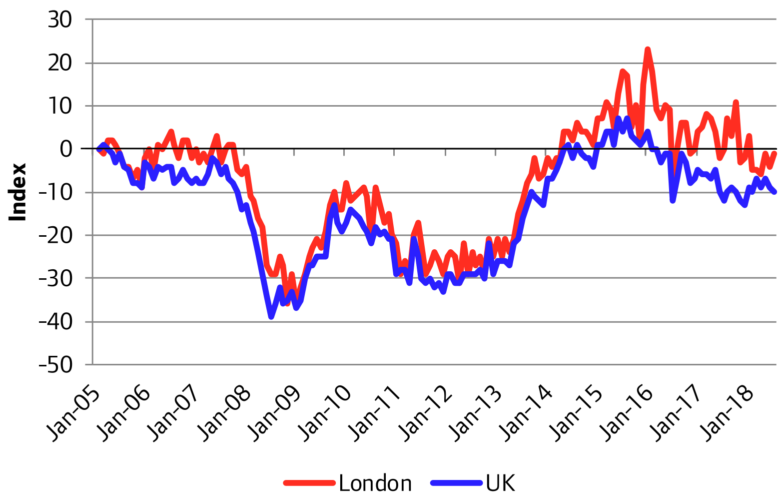


Consumer confidence in London remained negative in July

- 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 in London was -1 in July, up from -4 in June. This represents the sixth consecutive month of negative index scores for London.
- Sentiment was also more negative for the UK in July (-10) compared to June (-9). The UK has not shown a positive index score since January 2016.

Source: GfK NOP on behalf of the European Commission
Latest release: July 2018, Next release: August 2018

Consumer confidence barometer



Trends in pubs in London

By **Nye Cominetti**, Economist

- The number of pubs fell from 4,835 in 2001 to 3,530 in 2017, a fall of 27%, and an average loss of 82 per year. 2017 saw that trend continue, with 85 fewer pubs than in 2016.
- This reduction is driven by a fall in the number of 'small' pubs (defined as having fewer than 10 staff). The number of small pubs fell by 50% between 2001 and 2017 (from 3,390 to 1,680), whereas the number of 'large' pubs (10 or more staff) actually increased over this period (by 28%, from 1,445 to 1,850).
- Explanations for the decline in pubs include changing drinking habits and changing leisure preferences more broadly. Since 2001 there has been a large increase in the number of restaurants and cafes in London, more than offsetting the fall in the number of pubs.

In 2017 the GLA published a 'pubs audit', to look at what was happening to pubs in London. We recently updated this audit for 2018 - this supplement outlines some of the findings.

The 2017 audit showed that the number of pubs had fallen by a quarter since 2001. In response, the GLA has moved to protect pubs through the planning system. For example, under the Draft New London Plan boroughs should refuse planning applications that involve the loss of valuable pubs unless there is no prospect of the building being used as a pub in the 'foreseeable future'. The 2018 update shows that this trend has continued, with a further 85 pubs lost between 2016 and 2017, a 2.4% fall. See Figure A1.

1 Note that the campaign organisation CAMRA ('Campaign for Real Ale') also produce figures on pub closures. In a recent news report, for example, their data suggested there had been more than 50 closures in London between January and June 2018. These figures are not directly comparable with the figures used in this supplement, for several reasons, including: different data sources (we used the Inter-Departmental Business Register, whereas CAMRA use data collected by their local branches); they refer to closures, whereas we refer to net change in pub numbers (i.e. our figures also include pub openings); and potential differences in how 'pub' is defined. However, despite these differences, 50 closures over the first half of 2018 is roughly consistent with the most recent annual *net* change figure we report, of -85.

2 GLA Economics (2017) 2017 pubs audit

3 GLA Economics (2018) 2018 pubs audit

4 Specifically, those that 'have a heritage, economic, social or cultural value to local communities'.

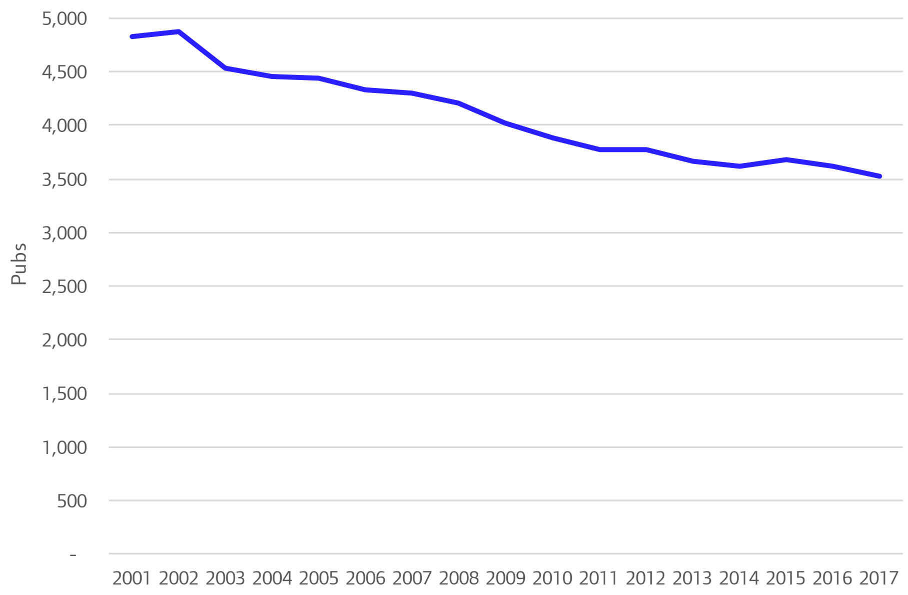


Figure A1: Number of pubs in London, 2001-17

Source: IDBR, ONS

The previous update highlighted the geographic unevenness of pub losses in London, and this is still the case. Some boroughs have seen significant pub losses (e.g. Barking and Dagenham, Newham, Waltham Forest, Croydon and Enfield lost about half their pubs between 2001 and 2017) whereas other boroughs have seen smaller losses or even increases (e.g. in Hackney there were 13% more pubs in 2017 than 2001).

One new element in the 2018 update is that we broke down the pubs trends by size, which was revealing. It turns out that whereas the number of small pubs (defined as having fewer than 10 staff) has fallen consistently since 2001, the number of large pubs (10 staff or more) has actually increased since 2011 (see Figure A2). As a result, there are now more large pubs than small pubs in London, with around 3,800 more people employed in London pubs in 2017 than 2001 (a 9% increase).

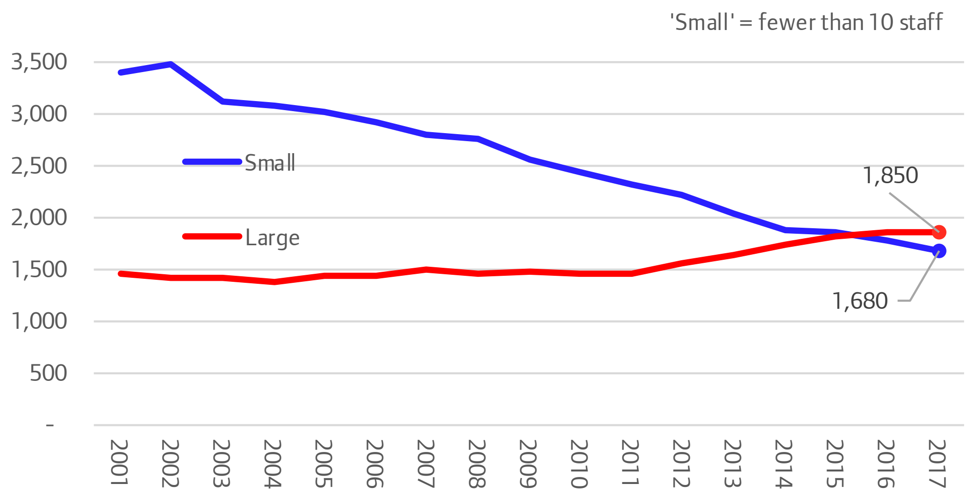


Figure A2: Trends in London pub numbers by size, 2001-17

Source: IDBR, ONS

Why are pub numbers in London falling, and should we be worried?

We have not yet looked into what is causing this decline in pubs. However, there are likely to be a number of causes. Changes in drinking habits are part of the story. People are drinking less, and beer is increasingly being bought 'off trade'. Others have pointed to the negative impact on the pub trade of business rates and of taxes on beer.

Changes in the way in which Londoners are choosing to spend their leisure time are likely to play a role in the fall in pub numbers. While there are fewer pubs, there are now more restaurants and cafes in London. Figure A3 below shows the trends in the numbers of pubs, clubs, restaurants, cafes and take-aways since 2001. While the number of pubs has fallen by 1,305 over this period, the number of restaurants and cafes has increased by over 6,000.

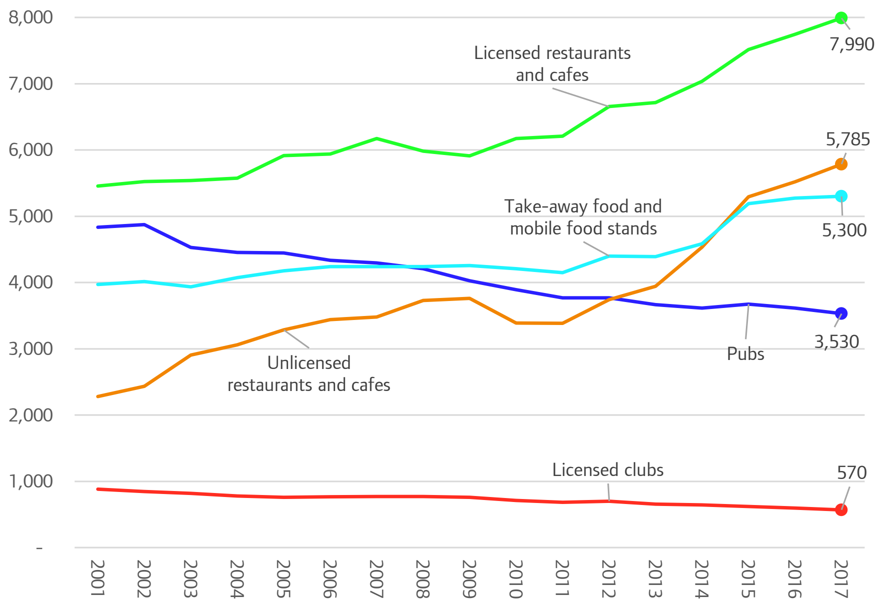


Figure A3: Number of pubs and related business units in London, 2001 to 2017

Source: IDBR, ONS

However pubs can have a unique value as a social amenity, offering a meeting place and bringing communities together in a way that cafes and restaurants don't. Pubs may also be more important as a social amenity in some places in London than others (perhaps where there are fewer other options for socialising), and more so for some groups of Londoners than others (perhaps those with a stronger pub culture). This means that, on top of the geographic unevenness mentioned above (some places have seen more pub closures than others), there may be an unevenness in terms of social impact.

Pubs can also have an intrinsic value as cultural and historic institutions. In London this may be less true of restaurants and cafes, although in other cities around the world, such as San Francisco and Buenos Aires, cafes and bars are protected for cultural and heritage reasons. Preserving these institutions may attract tourists, as well as being important for residents.

The protection of pubs in the Draft New London Plan draws on both the arguments above (pubs' heritage / cultural value and their social value) and adds a third - their economic value.

What next?

GLA Economics will continue to update the pubs audit on an annual basis. Despite plans for intervention, the downward trend in pubs numbers seems strong, given it is driven by changes in leisure and drinking habits. However, the Mayor has committed to undertaking research to explore the issue in greater depth, so we may know more next time. Meanwhile, GLA Economics will soon publish an evidence base on London's night time economy, which will be found on our publications page, and the GLA culture team will continue to develop policies to support London's cultural infrastructure.

5 GLA datastore: Number of public houses, licensed clubs, restaurants and takeaways by Borough

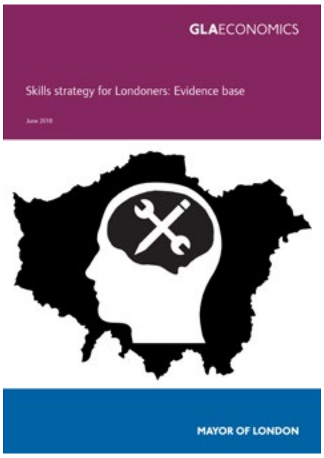
Our latest publications

We publish regularly on the state of London's economy, providing the latest economic data for London and interpret how this may affect policy. This includes analysis of recent developments in London's economy and forecasts for the next couple of years.

We provide analysis on sectors of the economy including tourism, retail, housing, health, science, technology and more.

We analyse recent developments in London's labour market, by sector and borough.

View all the GLA Economics publications on our website.



Skills strategy for Londoners, Evidence base
This skills strategy evidence base supports the Mayor's skills strategy, 'Skills for Londoners'. It covers the demand for and supply of skills, inequalities in skills, employer training, and the training and education system.

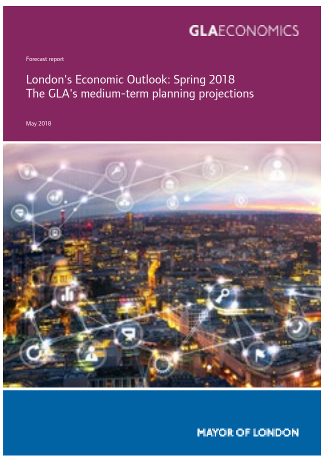
- Nationally, spending on adult education has fallen since 2010 which is reflected in lower participation. Between 2012/13 and 2016/17 the number of adult Londoners (age 19+) participating in classroom-based further education fell 41%, although the number of adult apprenticeships increased by 9% in this period.

Download the full publication.

Wider South East experimental labour market projections
These projections are to provide a shared understanding of the technical evidence to inform planning across the Wider South East (East of England, and the South East of England).

- The central projection for the East of England estimates that jobs will grow from 2016 at an annual average rate of 0.92% a year, equivalent to 32,000 jobs, to reach 3.912 million in 2041.
- The central projection for the South East of England estimates that jobs will grow from 2016 at an annual average rate of 0.98% a year, equivalent to 54,000 jobs, to reach 6.194 million in 2041.

Download the full publication.



London's Economic Outlook
Our latest London forecast published in May 2018 suggests that:

- London's Gross Value Added (GVA) growth rate is forecast to be 1.6% in 2018. The growth rate is expected to rise slightly to 1.9% in 2019, before reaching 2.2% in 2020.
- London is forecast to see increases in the number of workforce jobs in 2018, 2019 and 2020.
- London's household income and spending are both forecast to increase over the next three years, albeit at a relatively slow rate.

Download the full publication.

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