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The London economy

An end to uncertainty
By Bridget Rosewell

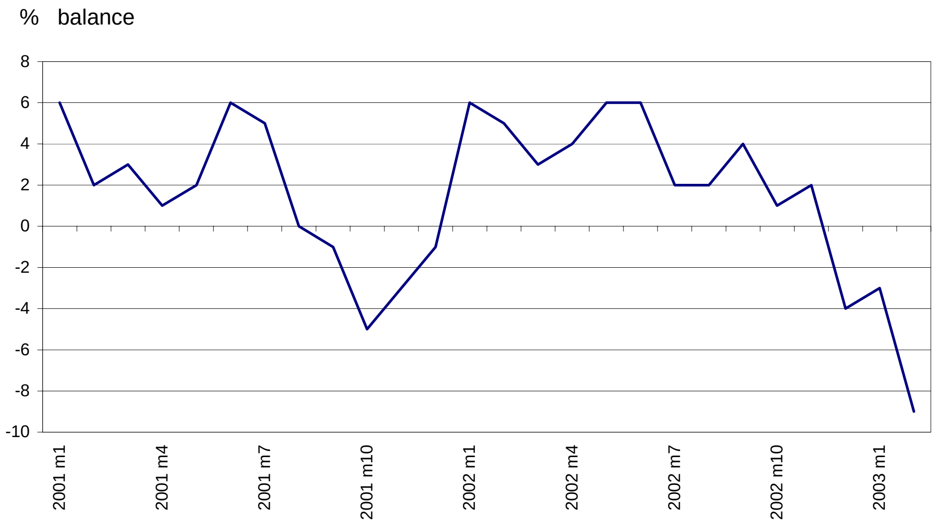
As I write, the war has started. Tony Blair survived the Commons bombardment and the bombardment of Iraq has begun. The stock market has jumped, the oil price has fallen and so has the price of gold as a result of certainty replacing risk.

These market movements have to be overlaid on other economic forces to understand what is happening in the economy. The last six months have seen the beginnings of an economic recovery based on slowing but still strong consumer spending, alongside increased government outlays and an end to the precipitate decline in investment. Internationally, the US economy has also been flexing its muscles again.

Most recently, however, consumer sentiment has turned negative, and the expected moderation in house price growth could still produce a significant downturn and housing market crunch rather than the more likely slowing to more sustainable rates of growth.

The overall consumer confidence balance is shown in Chart 1. It clearly illustrates the recovery from September 11, as well as the drop below the zero line in the last three months. On the other hand, the willingness to make major purchases, an element in the survey strongly correlated with consumer spending at the UK level, remains fairly robust. This can be seen in Chart 2. It is certainly nowhere near as low as was the case in 1991, or even 1995 - 1996. Moreover, the level in London is not significantly different from that in the UK as a whole, suggesting that those who think that London is doing significantly worse than the rest of the country may well be wrong.

Chart 1 Aggregate measure of UK consumer confidence



Source: Martin Hamblin GfK

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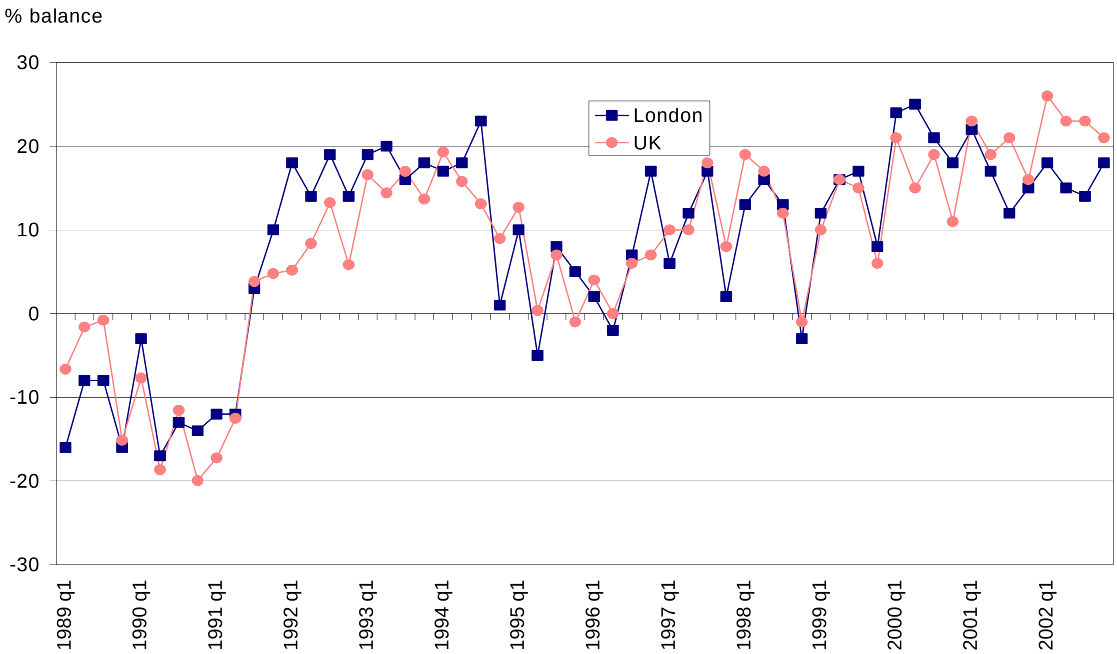
Chart 2 Consumer financial sentiment in regards to buying major purchases



Source: Martin Hamblin GfK

In addition, the latest labour market indicators show that unemployment has remained pretty stable. Although there have been redundancies in the city, these are still small scale in the context of London as a whole.

In the last Gulf war, there were two big things that pushed London into a deep recession. The first was the way in which high interest rates were already biting as the government tried to slow the economy. The second was the disappearance of tourists – from conference attendees and business visitors to people from the rest of the country visiting friends and relatives.

The first of these is not a problem on this occasion – the economy is in recovery phase, not downturn phase. The second is a potential problem. The tourist industry, as we have pointed out in previous editions, has still not recovered from the effects of September 11, Foot and Mouth disease and the global slowdown that began in 2001. Numbers from the 3rd quarter 2002 are up by about 6 per cent, compared to 2001, but still around 10 per cent lower than third quarter 2000. War will slow down, if not halt, recovery.

This affects retailers, as well as hotels, restaurants and the transport industry. Some commentators have suggested that the congestion charge is itself responsible for producing a slowdown in activity in central London and we address this directly in supplement 1 to this edition. Our analysis is that this conclusion is not well founded. While it is true that some parts of central London are seeing lower sales, this is more to do with the closure of the Central line on a temporary basis and the decline in visitor numbers than it is anything to do with the congestion charge. It is far too early to say what effect the charge will have on activity, and some evidence suggests that the time savings for those engaged in delivery rounds outweighs the cost of the charge, so that there are positive effects on activity as well as negative one.

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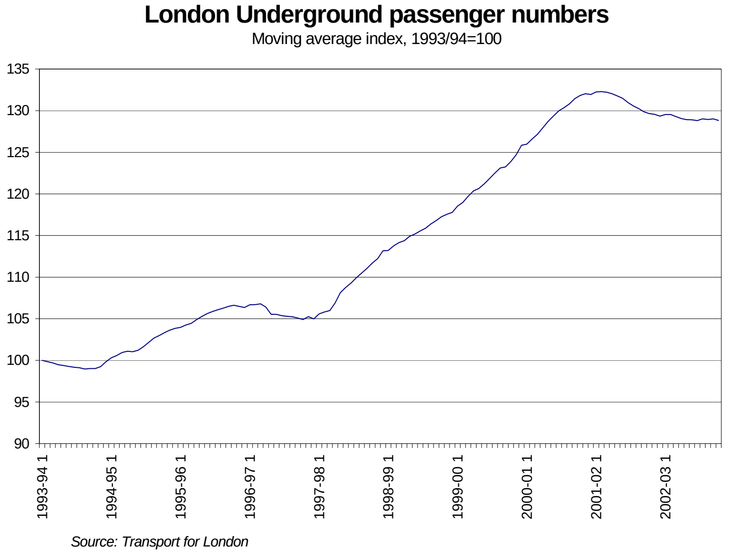
Economic indicators

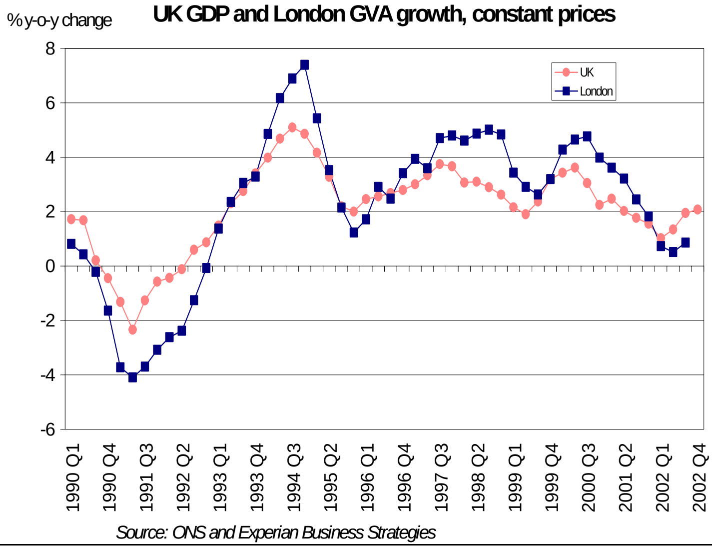
Source: TfL
Latest release: 04/03/03
Next release: 01/04/03

- Latest London Underground passenger numbers declined marginally by 0.15 per cent in early February compared to the previous month.
- The moving average index slipped slightly to 128.8 (in the period from 5 January to 1st February) from 129.0 in the previous period. This reduction was mainly due to the closure of the Central line on 25 January.
- However, other minor factors such as the fire fighters strike and the public's fear of potential terrorist attacks in London contributed to this reduction.



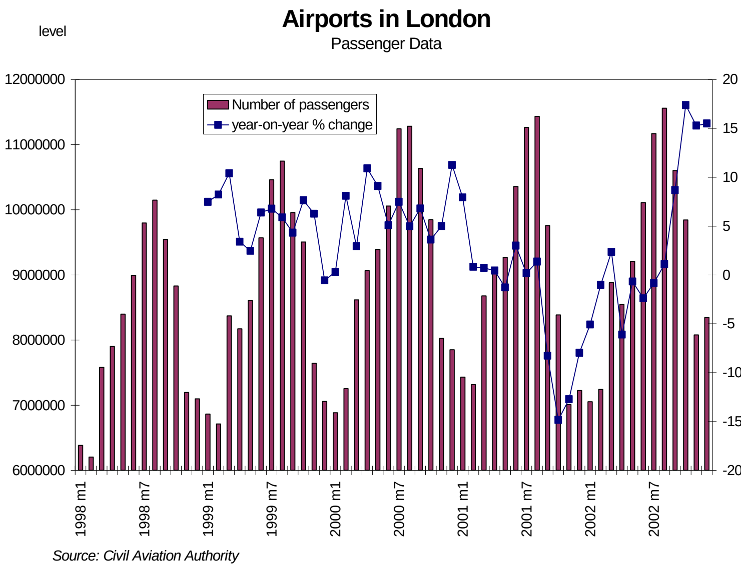
Source: ONS and EBS
Latest release: 5/12/02
Next release: Spring 2003

- Official figures for GDP in 2002 Q4 increased by 0.4 per cent from the previous quarter.
- Despite the low increase in the quarterly percentage change in UK GDP, the annual rate was stronger in Q4 at 2.1 per cent compared to the previous quarter at 2.0 per cent.
- In Q3 London's GVA growth rose by 0.9 per cent from the previous quarter. This represents a recovery from the slowdown in the second half of 2000.



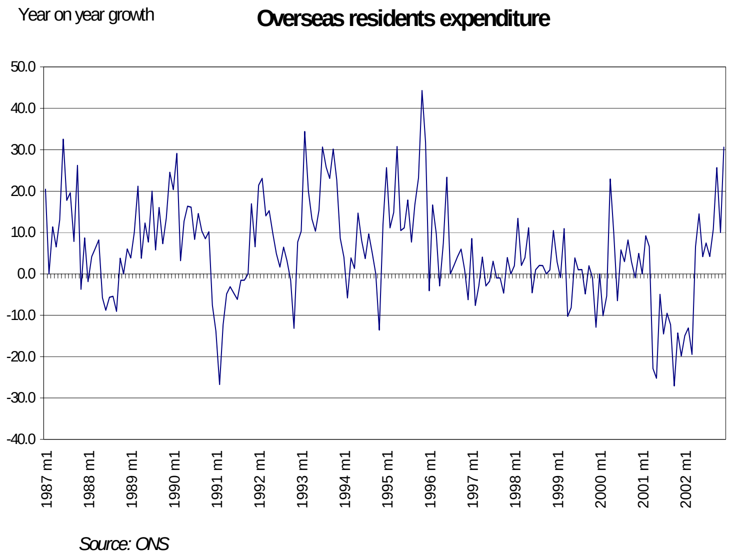
Source: Civil Aviation Authority
Latest release: 13/03/03
Next release: not known

- The total number of passengers in airports in London showed a recovery in December 2002 from the previous month.
- The annual growth in airport traffic was 15.5 per cent in the last month of 2002. This is a bit below the strongest annual rate of 17.4 per cent, indicating a healthy activity in the London tourism industry.



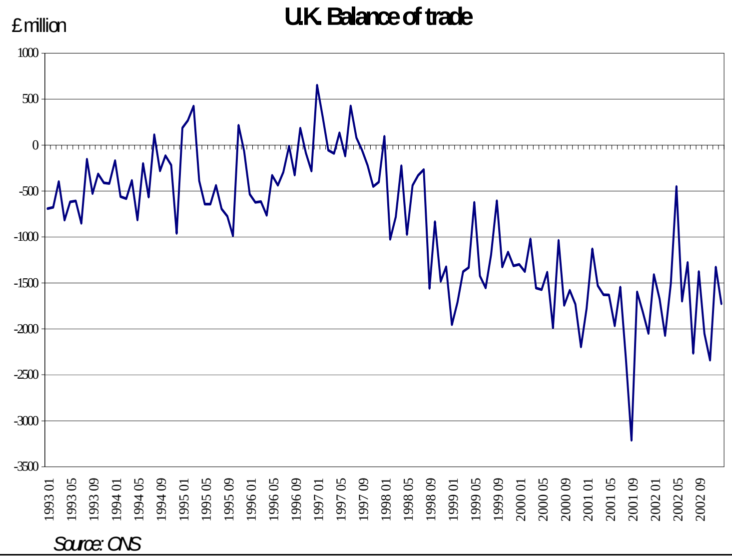
Source: ONS
Latest release: 05/02/03
Next release: 08/04/03

- Overseas expenditure in the UK shows a further recovery at the end of 2002, rising by 30 per cent in December from the previous year.
- Overseas visitors have been spending more in the UK economy since the beginning of 2002, which is reassuring considering the negative effects of Foot and Mouth disease and the aftermath of September 11 in 2001.



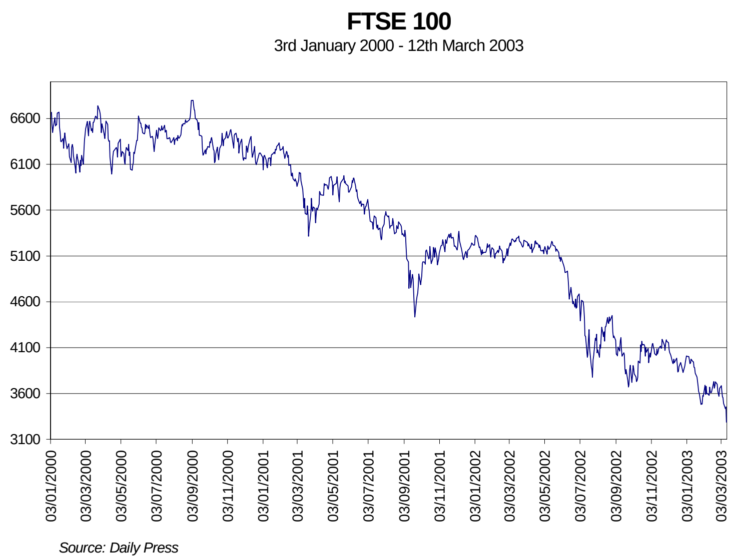
Source: ONS
Latest release: 11/03/03
Next release: 07/04/03

- The UK trade deficit deteriorated in January 2003 from the previous month.
- Although exports rose, given the recent decline of the pound in relation to the euro in the past month, the increase in imports outpaced the increase in exports.
- The worsening of the deficit in total UK trade balance was mainly attributed to the increasing deficit of goods in January. The trade in services increased its surplus.



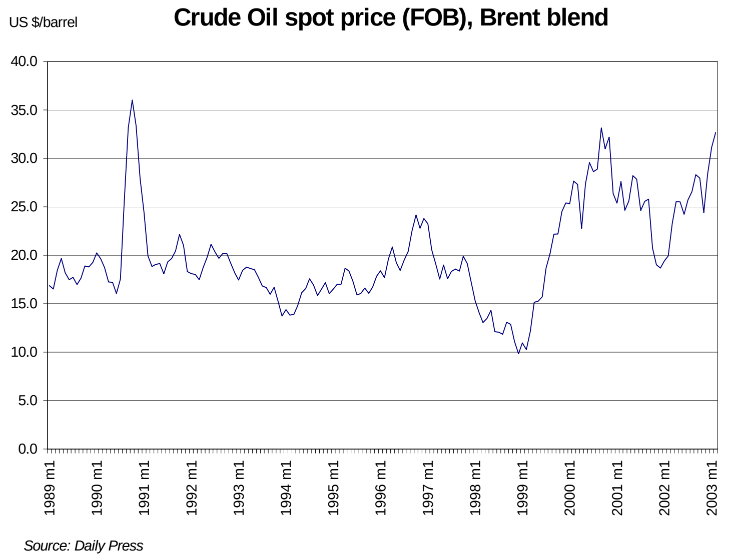
Source: Financial Times
Released: Daily

- UK equity prices remained volatile in March. The FTSE 100 index showed a downward trend in late February and early March.
- Moreover, the FTSE 100 index has halved its value from its peak in 2000, standing now at a level of 3,287. This is the lowest level recorded since mid 1997.
- The perception that the war in Iraq is a more likely event has caused the share index to plunge by 18 per cent from the beginning of this year.



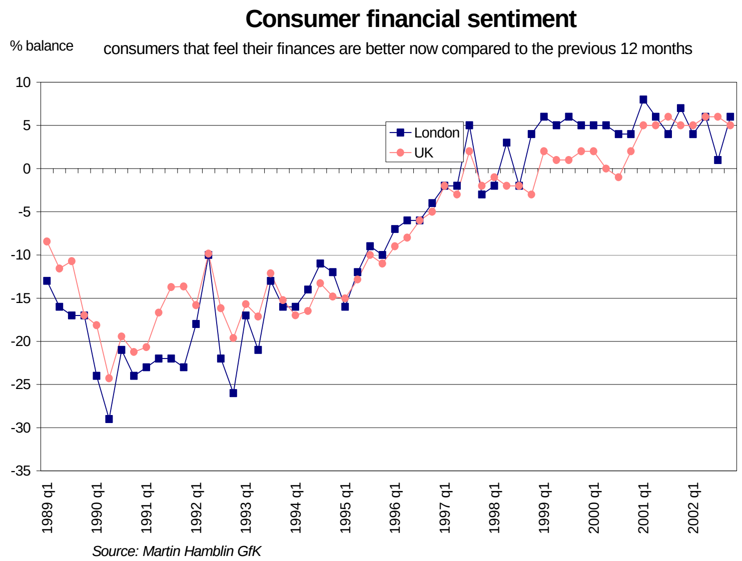
Source: Daily Press
Released: Daily

- Increasing fears of an imminent war in Iraq and the realisation that a disruption of Middle East oil supplies could be more serious than anticipated, have increased crude oil prices by 60 per cent in February from the previous year.
- Venezuelan oil production stoppage, compounded by a stronger demand for heating due to a severe northern winter, has sharply reduced US oil inventories.
- Higher demand by the US, the world's biggest oil consumer, has accentuated the rise in oil prices, reaching comparable levels to its peak in 2000.



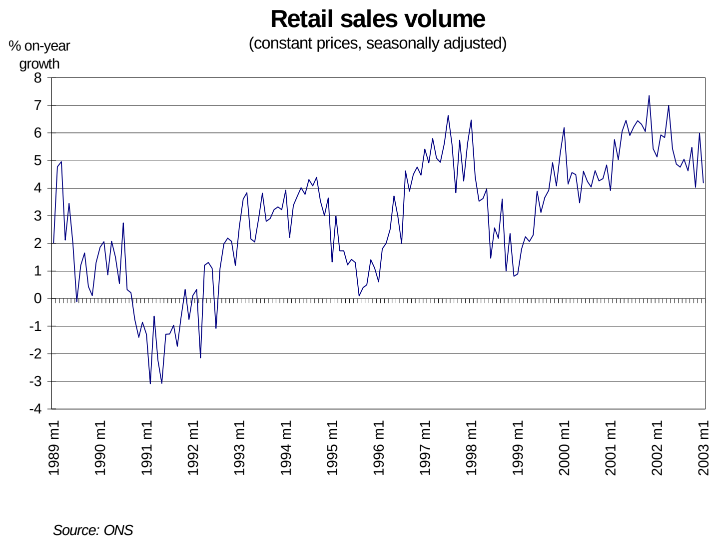
Source: Martin Hamblin GfK
Latest release: 12/02/03
Next release: 01/05/03

- Despite weaknesses in consumer sentiment at the end of 2002, individuals in the UK continued to feel optimistic about their future financial position.
- The balance of UK consumers reported as feeling confident that their finances will improve over the next year was 13 per cent in 2002 Q4. Although this balance was a bit down from the previous quarter, it remained positive.
- Londoners are feeling more optimistic than consumers in the UK as a whole in Q4.



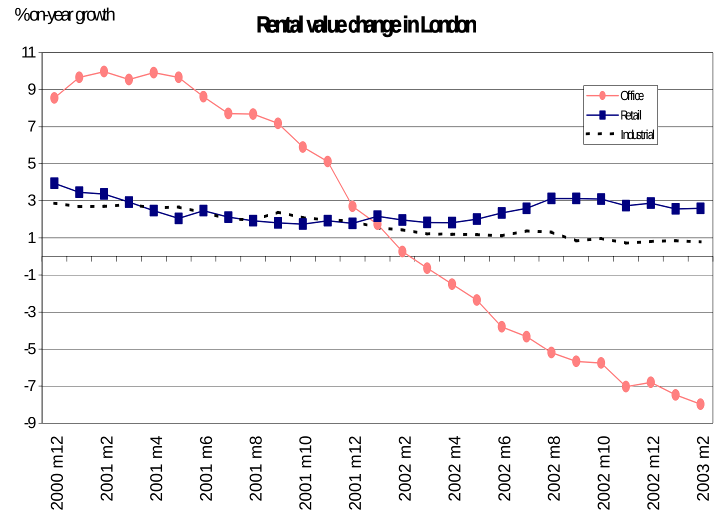
Source: ONS
Latest release: 20/03/03
Next release: 20/04/03

- UK retail sales volume in January was 1 per cent below the December figure. This decline was mainly related to a drop in the volume of sales from non-food stores, while the volume of sales from food stores was unchanged.
- Non-food stores include textiles, clothing and footwear, household goods, etc.
- Despite the marginal decline in retail sales volume in January, sales were still 4.2 per cent higher than the January 2002 level.



Source: Insignia Rental growth
Latest release: February 2003
Next release: not known

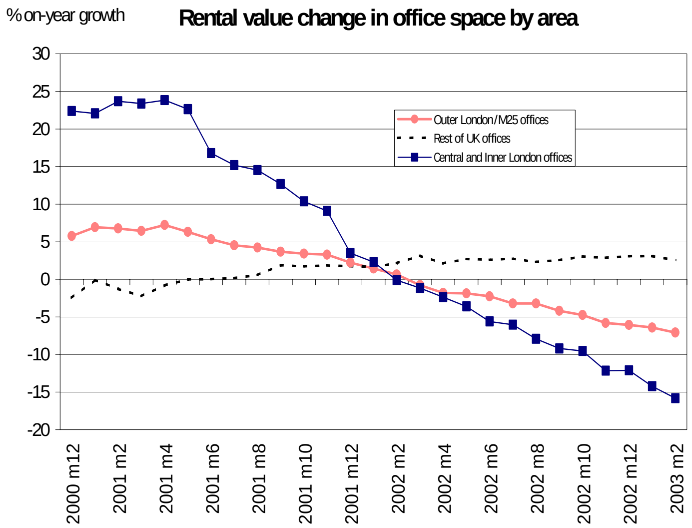
- Rental values in the retail and industrial sectors continued to show stability and relative good performance, suggesting a healthy activity in these sectors and steady demand for office space.
- By contrast, since the second half of 2000 the annual growth of rents for office space has been declining, particularly from February 2002 where negative growth is recorded. This downward trend has been driven by a combination of weak demand and extra availability of office space from companies within the financial and business sectors in London.



Source: Insignia Richard Ellis

Source: Insignia Rental growth
Latest release: February 2003
Next release: not known

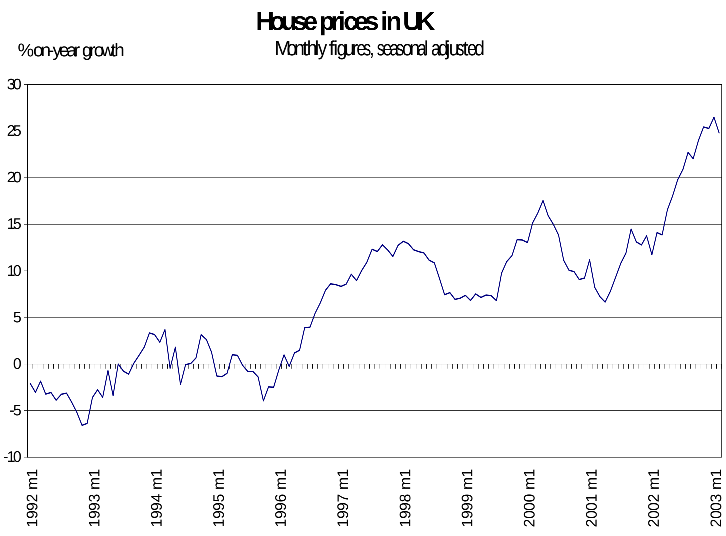
- The recent decline in the rental value of London's office space is mainly due to the accelerated fall of rents in offices located in central and inner London.
- Growth of office sector rents in central and inner London show negative growth at –15 per cent in February.
- Annual growth of rent for office space outside London shows less vulnerability to global slowdown and stable demand for offices.



Source: Insignia Richard Ellis

Source: Nationwide
Latest release: 03/03/03
Next release: 03/04/03

- There are signs that UK house price growth slowed in February, based on Nationwide figures.
- The Nationwide house prices index grew by 0.4 per cent in February compared to 1.7 per cent in the month before. This pushed down the annual UK house price inflation to 24.8 per cent from 26.5 per cent in January.



Source: Nationwide

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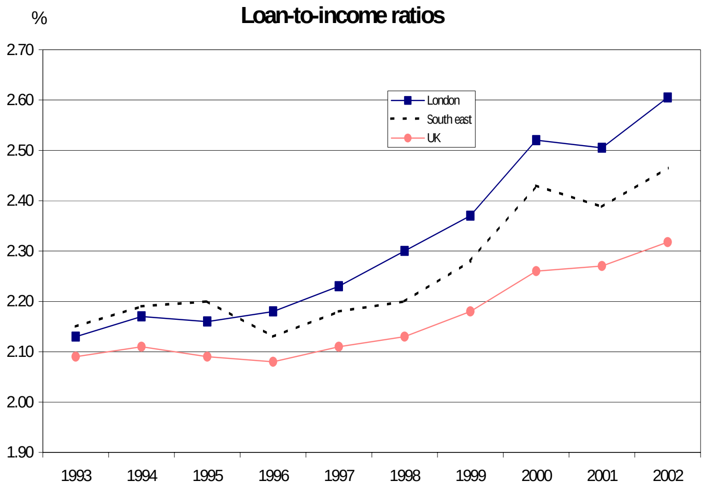
Source: Council of Mortgage Lenders
Latest release: February 2003
Next release: May 2003

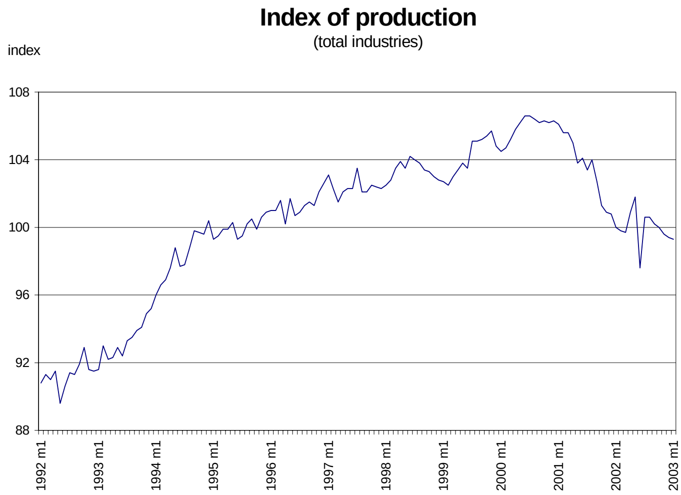
- The Council of Mortgage Lenders (CML) provides information on loan-to-income ratios for the UK and regional level. This indicator is calculated as the ratio of average gross advance mortgage loan over average income of all buyers.
- Latest data indicates that house buyers in London continued to increase their debts in relation to their income more substantially than buyers in southeast and the rest of UK in 2002.
- Moreover, the differential on the loan-to-income ratio in London with the rest of the UK has widened over time.



Source: Council of Mortgage Lenders

Source: ONS
Latest release: 11/03/03
Next release: 9/04/03

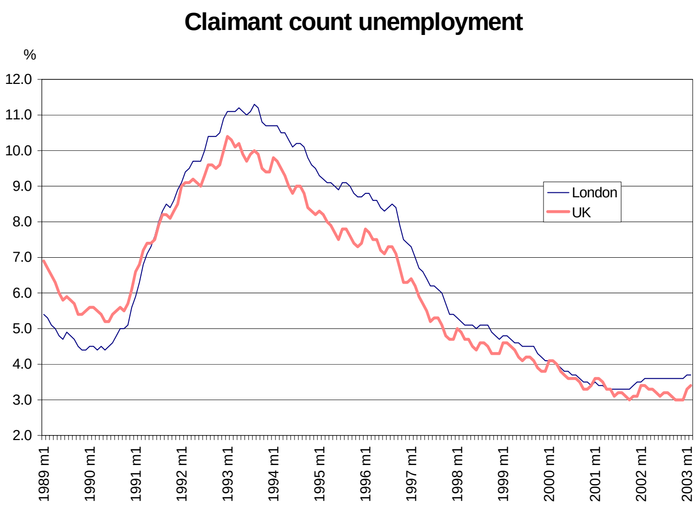
- Despite the fact that output in manufacturing industries showed recovery in January this year, the output in other industries such as electricity, water supply and mining, showed a slow down from the previous month.
- This caused the UK index of production of total industries to decline marginally in January, standing at 99.3. However, output has improved since the slowdown in activity over the Jubilee celebrations in June 2002.



Source: ONS

Source: Labour Force Survey
Latest release: 19/03/03
Next release: 16/04/03

- In February, the labour market remained tight with little changes in the claimant unemployment rates in the UK, but not in London.
- Unemployment data, adjusted by the population figures in the Census of 2001, indicates that the claimant unemployment rate in the UK was 3.4 per cent in February slightly up by 0.1 per cent from the previous month.
- In London the February claimant unemployment rate was flat at 3.7 per cent.



Source: Labour Force Survey

Supplement 1

Response to claims that congestion charging is holding back London's economic recovery

By Alon Carmel

On 28th February 2003, The Evening Standard reported that according to the Centre for Economics and Business Research (CEBR), congestion charging would cost the London economy £170 million this year. While the CEBR press release is actually a lot more cautious than this – saying that congestion charging *could* cost London £170m, we believe there is no reliable evidence to support even this assertion. Rather than costing the London economy money, the congestion charge reduces costs by ensuring that a scarce resource (the road network) is allocated more efficiently. The downturn in the London economy is nothing to do with congestion charging, but is driven by the factors outlined below.

Factors behind observed slowdown in London economy

a) Global slowdown

- World stock markets have undergone the largest decline for 30 years. They are currently particularly depressed as a result of the uncertainty surrounding a war in Iraq.
- Oil prices are high for the same reason (Brent Crude is above $30 per barrel and in the US the price reached $40 per barrel at the beginning of March). High oil prices raise inflation, which in turn contribute to a slowdown in the economy.
- The world economy has been in a downturn since 2001.
- US growth in 2002 was 2.4 per cent in real terms, still down from 3.8 per cent in 2000 but higher than in 2001, indicating that the recovery may be beginning.
- US Stockmarkets – the Standard and Poor's composite lost nearly a third of its value between late 2001 and early March 2003. The Nasdaq Composite lost more than three-quarters of its value since the peak in 2000.
- European shares fell to a six year low at the end of February as a result of accounting scandals, disappointing earnings and economic data and the overhanging threat of war.
- Finance Ministers of the G7 industrial countries have supported the idea that uncertainty surrounding a possible war in Iraq is one of the main causes of the global slowdown[1].

b) UK slowdown

- UK economy as a whole grew by only 1.6 per cent in 2002 – Office of National Statistics (ONS) have had to revise their figures down at the end of February. This was significantly below the Treasury's forecast of 2.5 per cent.

[1] FT 23/2/03 'Markets peer through the fog of war'

- The FTSE 100 had by the beginning of March 2003 lost more than half its value since 2000[2].
- Business investment fell at its steepest rate for 40 years in 2002 (10.1 per cent).
- Consumer confidence is at its lowest since just after the September 11th attacks on the US. A MORI poll at the end of February showed that 58 per cent of respondents believed that the general economic outlook would deteriorate in the next 12 months[3].
- Most analysts and commentators agree that the main cause of this UK-wide slowdown, and the continued delay in the recovery, is the uncertainty surrounding a war in Iraq.

c) London slowdown

- The latest reliable figures for London's growth rate for 2002 show growth of 0.9% (based on annualised third quarter growth estimates), compared with 4% in 2000.
- Financial and business services account for a large part of London's economy. A bearish stock market will lead to lay offs in this sector and this will disproportionately affect London.
- Another factor affecting London disproportionately is the effect on overseas tourist visitors. London is more dependent on overseas tourists than the UK as a whole. There is individual evidence that especially US tourists have begun to be deterred from visiting the UK as a result of the threat of war (the same thing happened in 1991). Tour operators have reported a drop in bookings – especially after the televised pictures of tanks at Heathrow.

[2] FT 11/3/03 'London extends falls as UN heads for split'

[3] www.mori.com

Effects of Congestion Charging

Retail sector

- The Evening Standard has reported that shops inside the congestion charging zone have lost revenues as a result of the charge[4]. However, many of the big retail chains in central London have named the closure of the central line as a far bigger threat to their profits, e.g. John Lewis.
- Even if it were true that some part of the drop in retail revenues in central London is attributable to the congestion charge, this will not cost London's economy as a whole. While the charge may deter shoppers from buying in central London, it will not discourage them from spending at all – just make them do their shopping in outer London instead of in the centre. This will not lower consumer spending as a whole in London, but merely redistribute it from the centre to the periphery. Other factors may discourage consumers from spending, for example, the global slowdown, but this has nothing to do with congestion charging.
- In addition, it must be remembered that congestion in central London is a major cost to all businesses because of the delays and uncertainties it causes. Therefore, less congestion leading to more predictable journey times will reduce costs and in turn boost London's GVA.

[4] 19/02/03 'Congestion slump hits shops'

How many people are actually deterred?

- According to figures published in the Evening Standard[5], 95,000 paying vehicles entered the congestion zone on Day Seven of the charge (Thursday 23/2/2003), up from 87,000 on Day One. TfL estimated that 150,000 vehicles would enter each day, but that was based on term time whereas the 23/2 was during half term. Every day around 1 million people enter the congestion zone.
- If 95,000 people came in by car out of an expected 150,000, it means that 55,000 people stayed away. Even if we ignore the half term holidays and assume that this is all down to congestion charging then this represents only 0.6 per cent of people entering central London. It is extremely unlikely that such a small percentage of people could be responsible for shop revenue drops of 10 per cent or even 50 per cent as reported in the Evening Standard.

Conclusion

In summary, it is much too soon to say what has been the impact of congestion charging. It is clearly ludicrous to attribute the current economic slowdown to congestion charging in the context of much more powerful factors operating and before any reliable data are available on the effects of congestion charging (a mere 2 weeks after the start of the scheme). Transport for London reports that the first 2 weeks of congestion charging has seen a reduction of traffic of around 20 per cent on average, and with minimal disruption for a scheme of this size and complexity.

[5] 24/02/03 ‘Crunch time for congestion’

Supplement 2

Transport trends for London

By Alon Carmel and Adarsh Varma

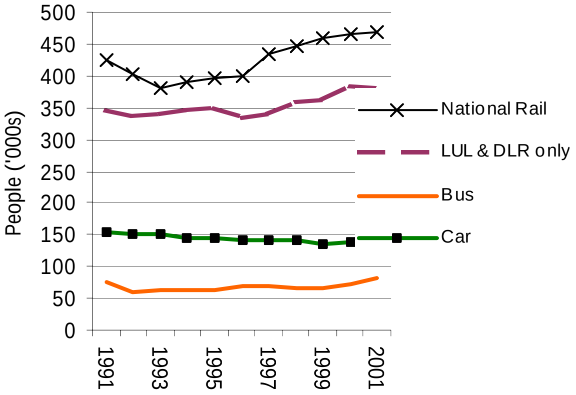
'Good transport…is not just important for the economy: it is also a key public service which contributes to the social well being of an area.' – John Prescott, Deputy Prime Minister, Foreword to *Our towns and cities: the future, Delivering an urban renaissance*, November 2000

- An efficient transport system is key to stimulating and accommodating economic growth and improving quality of life.
- Transport for London estimate that the population and employment projections in the London Plan between 2001 and 2016 will result in an additional two million trips per day across all modes. On a typical weekday, around 1.1 million people enter central London between 7am and 10 am.
- The trends for transport demand, supply and costs reveals that there is a great need for substantial and sustained investment in London's transport system to enable London, the heart of the UK economy, to continue to grow and prosper.

Rising demand for transport

The recent trends for travel to work in central London are shown in Chart 1. Overall demand has increased by around five per cent since 1991. Demand has increased for all modes except car, which has declined. The biggest rise has been in rail use which grew by 10 per cent. Both buses and the Underground have increased by nine per cent. Underground growth averaged three per cent per annum in the past five years.

Chart 1 People entering central London during morning peak[1]: 7am-10am



Source: Tfl

[1]In addition to journeys terminating in central London, all journeys passing through central London are included.

Meanwhile, car use has declined by 22 per cent in the same period. The proportion of journeys by car has decreased from 11 per cent to 15 per cent, while the proportion of public transport has gone up from 81 per cent to 85 per cent in the last five years.

In 1999 only 13 percent of central London's 1.28 million jobs were accessed by car or van, compared to 78 per cent by public transport. Inner London (excluding central London), with 1.2 million jobs, saw 40 and 43 per cent respectively. Two-thirds of the 1.7 million jobs in outer London were accessed by car or van and only 19 per cent by public transport.

The primary driver of the increase in demand is the growth in population and jobs. Since 1989 the population of London has increased by 600,000. The London Plan projects further growth of 700,000 residents by 2016.

The rise in demand for rail journeys is connected with the rise in commuting numbers. Since 1992 net commuting into London has increased by around 18 per cent[6]. Underground passenger volumes have increased nearly 27 per cent in the past ten years. This reflects the fact that use of the Underground tends to increase with rising disposable income, and disposable income in London has increased over the last decade. It might also be the result of increased overseas tourists who tend to prefer the Underground to bus or rail services and private cars.

Passenger travel on the Docklands Light Railway has increased significantly in line with expansion of the network and the development of Canary Wharf, with passenger volumes more than doubling in the last five years. The development of the Thames Gateway area, which is a national regeneration priority, will continue to add to the pressures on the Docklands Light Railway and surrounding transport networks.

The increase in demand for bus journeys since 2000 is probably caused by the reduction of bus fares in real terms. Studies of the price elasticity of demand of bus travel have consistently shown quite high elasticities, indicating that the demand for bus services is highly sensitive to price changes. The decrease in the number of people using cars to get into central London in the peak period is presumably due to a combination of costs. Firstly, the high (time) costs caused by congestion (average speeds in central London are under 10 mph) and secondly the high costs of parking/difficulty finding parking spaces.

Limits to increasing supply in short run

While demand has increased dramatically in the last decade, supply of transport is constrained in the short run.

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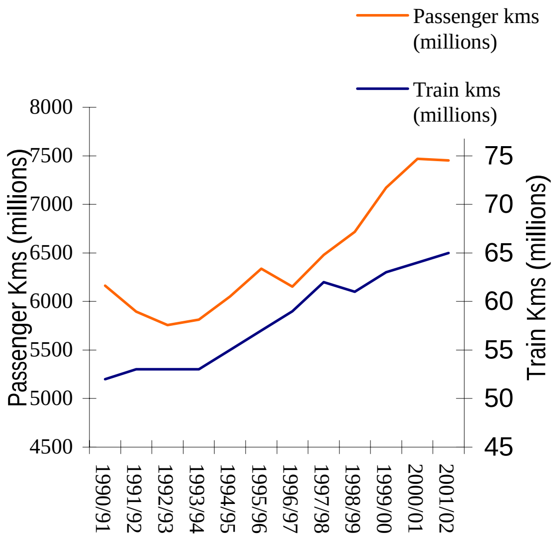
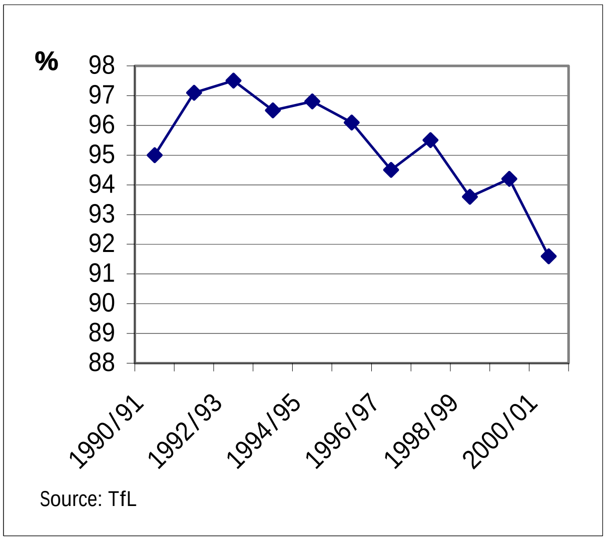
[6] GLA Economics Working Paper 1: Labour market balances and employment in the wider South-East, Feb. 2003

Chart 2 Underground capacity and demand



Source: Tfl

Chart 3 Underground loading and reliability



Source: LUL, Tfl

Chart 2 shows that the increase in demand (passenger kilometres) over the last decade has been partly met by increases in supply of trains (train kilometres) and partly by trains carrying more passengers – measured by the train load (passenger kms divided by train kms). Services have already been increased as much as is possible with the existing network. Investment in track and rolling stock will increase as a result of the Public Private Partnership (PPP) contracts being finalised, but it will take time before these investments deliver improved services.

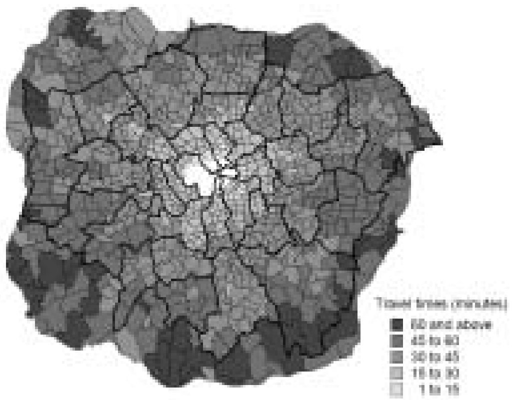
Chart 3 shows that as train load has increased, reliability (measured by percentage of planned train kms actually operated) has declined.

Costs: journey times

The average travel time to work in Autumn 2001 was more than twice as long for those working in central London (averaging 57 minutes) compared with Great Britain as a whole (averaging 27 minutes). The average journey time for car drivers working in central London was 51 minutes, slightly higher than for Underground travellers (49 minutes) and bus travellers (48 minutes), but lower than rail travellers (71 minutes). These figures clearly reflect the fact that the average rail commuter tends to travel farther. Chart 4 and 5 uses TfL zonal data to show the difference between travel times to central London using the highway and using public transport[7].

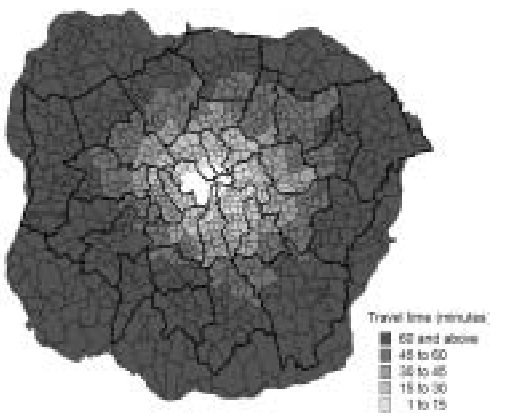
[7] Central London is shown by the central grey zone, which is roughly the size of the Underground zone 1.

Chart 4 Travel times to central London by public transport (2001)



Source: TFL

Chart 5 Travel times to central London by highway (2001)



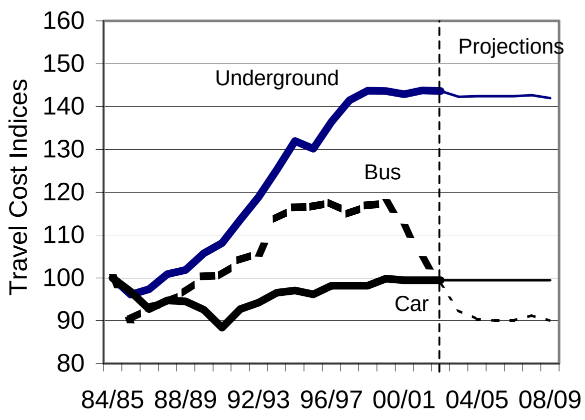
Source: TFL

Chart 4 shows that central London is far more accessible via public transport (including bus, rail and Underground) than via private cars (Chart 5). Increases in the number of buses and routes coupled with the effectiveness of the congestion charge in reducing private car traffic should result in shorter average journey times for many peak period travellers.

Costs: passenger fares

Between 1984 and 2000 the real cost of Underground and bus fares rose by around 40 per cent and 20 per cent respectively. Car costs have remained constant on trend. Since 2000 the real cost of bus journeys has been reduced and the real cost of Underground fares has been frozen.

Chart 6 Fare trends - bus, underground and car (in pence per passenger km)

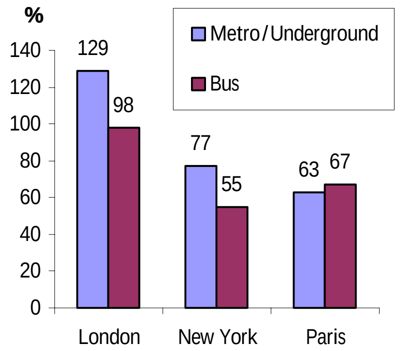


Source: TfL

The congestion charge will increase the cost of motoring in central London and so narrow the gap between public transport and car costs, in turn encouraging a switch to public transport. This will increase the pressure on the public transport system even though a lot of it will be absorbed – in the short run – by the increases in bus services.

Chart 7 shows the different approaches to funding transport in three major world cities. The greater ratio of fare revenues to operating costs in London reflects the view that passengers should pay a more market-driven price for the services they consume and an aversion to subsidies.

Chart 7 Passenger fare revenue as a percentage of operating costs (1998)



Source: TfL

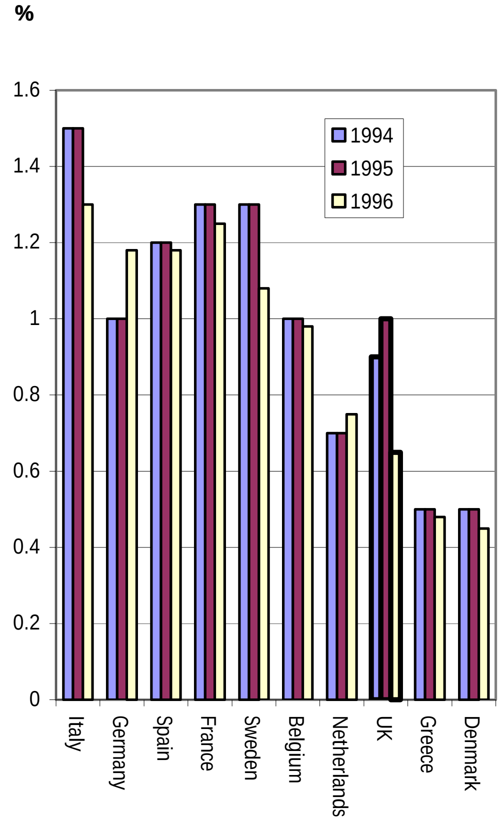
Buses – the short run solution

The heavy reliance on public transport for journeys into central London necessitates critical improvements in service and reliability. In the short run the excess demand can only be met by increasing the supply of the transport service that requires the least investment in infrastructure, namely buses.

By the time of the introduction of congestion charging on Feb 17, there were 300 more buses on the roads compared to the previous year, and 11,000 extra passenger spaces in the peak hours. In the long run, however, the increased numbers of buses will not be enough to meet the expected additional two million journeys a day by 2016. To meet this added demand there would need to be significant investment in transport infrastructure across the board – rail, road and Underground. In particular it will be important to increase the investment in the modes of transport that are able to carry large numbers of passengers efficiently.

Chart 8 outlines the relative paucity of investment in transport infrastructure in the UK as compared with other European countries. (The figures are from 1996). If the UK fails to invest sufficiently in transport infrastructure to accommodate projected growth in population and employment, it risks losing some of its international competitiveness. This is the same for London.

Chart 8 Investment in transport infrastructure as percentage of GDP



Source: Commission for Integrated Transport

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Data Sources

Tube Usage	Further information contact Transport for London on 020 7941 4500
FTSE 100 Index	Further information see www.ft.com or the daily Financial Times
Brent Crude oil	Further information see www.ft.com or the daily Financial Times
Office Space Demand	Further information see www.cbhillierparker.com
House Prices	Nationwide house price data from www.nationwide.co.uk/hpi/
	Land Registry data from http://www.landreg.gov.uk
Consumer Confidence	Further information see www.martinhamblin.co.uk
Average earnings	Data available from www.statistics.gov.uk
Retail Price Index	Data available from www.statistics.gov.uk
MEW	Data available from www.bankofengland.co.uk
Retail Sales	Data available from www.statistics.gov.uk/rsi
Unemployment rates	Data available from www.statistics.gov.uk
GDP/GVA Growth	Data available from Experian Business Strategies on 020 7630 5959
Balance of Trade	Data available from www.statistics.gov.uk
Index of Production	Data available from www.statistics.gov.uk
Manufacturing Expectations	Further information see www.cbi.org.uk
Services Sector	Data available from www.cips.org
Profitability	Data available from www.statistics.gov.uk
Tourism - Overseas Visitors	Data available from www.statistics.gov.uk
Tourism - Domestic Visitors	Data available from www.londontouristboard.com
London Airports	Data available from www.caa.co.uk

Abbreviations

BCC	British Chamber of Commerce
CBI	Confederation of British Industry
FTSE 100	Financial Times Stock Exchange 100 index of stocks traded on the London Stock Exchange
GDP	Gross Domestic Product
GVA	Gross Value Added
ILO	International Labour Organisation
LCC	London Chamber of Commerce
MEW	Mortgage Equity Withdrawal
ONS	Office of National Statistics
RPI	Retail Price Index
CIPS	The Chartered Institute of Purchasing and Supply
EBS	Experian Business Strategies
CML	Council of Mortgage Lenders

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GLA Economics

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London's Economy Today is published on the GLA website on the third Tuesday in every month. It seeks to provide an overview of the current state of the London economy, publishing a changing selection of the most relevant and up-to-date data available. It will track cyclical economic conditions to ensure that they are not moving outside the parameters of the underlying assumptions of the GLA and central government.

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