Macroeconomic scenarios for London's economy post COVID-19

Scenarios approach, storylines and projections to 2033

20 June 2023

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Disclaimer

- This fourteenth output of the macroeconomic scenarios project updates the previous output published on 14th December 2022. It is an interim output, which the Greater London Authority is making available for external stakeholders tackling the ongoing challenges of London's economy.

- The scenarios:
  - are **not** meant to represent optimal policy responses, but different futures against which policy responses could be tested.
  - are **not** definite forecasts – they do not represent what we think will happen but what could plausibly happen under alternative assumptions about the future.
  - are inevitably subjective, although they have been informed by discussions with internal and external analysts and economists.
  - do **not** capture the full range of uncertainty about the future, which is likely to lie outside the range of the scenarios.

- We continue to track actual data so we can review the likelihood of alternative scenario outcomes.

Executive Summary (1)

- This pack is an update of the GLA Economics-led project developing scenarios for London's economy post COVID-19. It includes new medium-term projections and GVA projections to 2033.
- These scenarios incorporate the latest intelligence from the Bank of England forecast for the UK economy of 11th May 2023 and the OBR forecast for the UK economy of March 15th 2023.
- The scenarios also include data on output up to Q3 2022 and jobs up to Q1 2023, which point to a still-strong output recovery across 2022 and a job market running hot into early 2023.
- Our baseline scenario now see London avoiding a recession, as recent data have proved resilient. The key source of economic risk remains the rapid pace of inflation. If inflation remains higher for longer, this will drag on real incomes and prompt the Bank of England to raise rates further.
- The main aim of this project is to develop a set of high-level macroeconomic scenarios to inform London's recovery strategies, reflecting unusually high uncertainty in the economic outlook. The scenarios are intended as a common framework/set of assumptions to inform further analysis.
- More information on project aims, an overview of the scenarios approach, and underlying scenario assumptions are available in earlier versions of the macroeconomic scenarios.

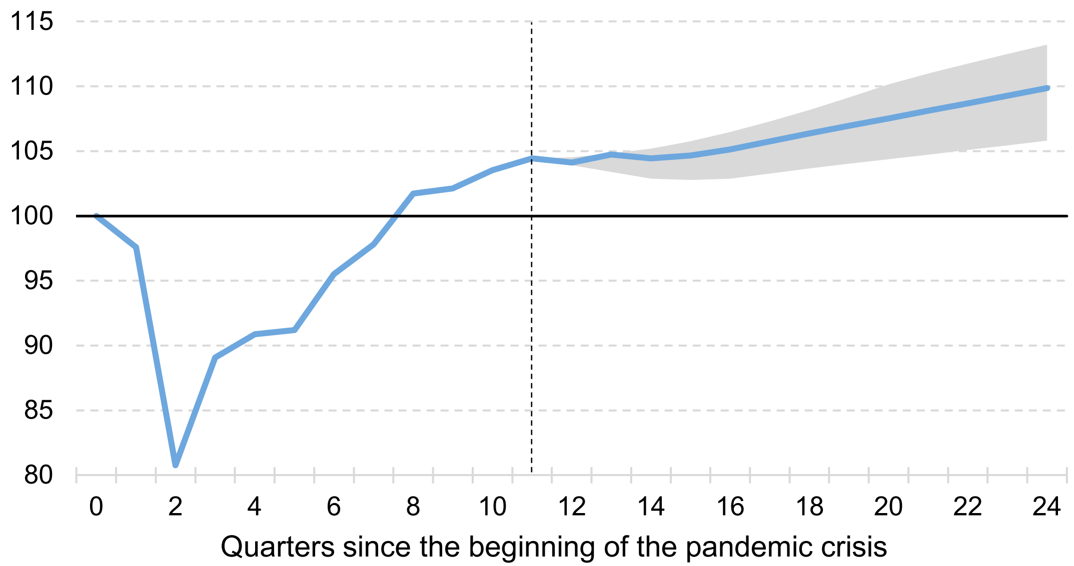
Executive Summary (2)

- Under the broad headings of resilience to shocks and policy support, we make assumptions around the persistence of high inflation, household savings and incomes, consumer and investor confidence and the intensity and the impact of tighter macroeconomic policy.
- The baseline outlook has improved substantially, with most major forecasters no longer anticipating a recession at the UK level. While the UK outlook is largely stagnant in the coming quarters, London's households and businesses show much less pessimism than national averages.
- Despite the upgrade, the outlook for growth is weak on average, and risks remain tilted to the downside. London's growth in 2021 and 2022 was rapid, but high inflation will drag on real incomes and aggregate demand. Perhaps the key question for scenario planning is how households absorb this shock. How persistent inflation proves, how businesses respond, how financial sector disruption plays out and the path of fiscal and monetary policy are other key risks.
- Three core scenarios have been developed: Scenario 1 – Fast economic recovery; Scenario 2 – Gradual economic recovery; and Scenario 3 – Recession, slow recovery.
- Other scenario dimensions include: Brexit & migration; International context; Technology & innovation; Financial climate; Political economy; Economic geography and climate change impacts.

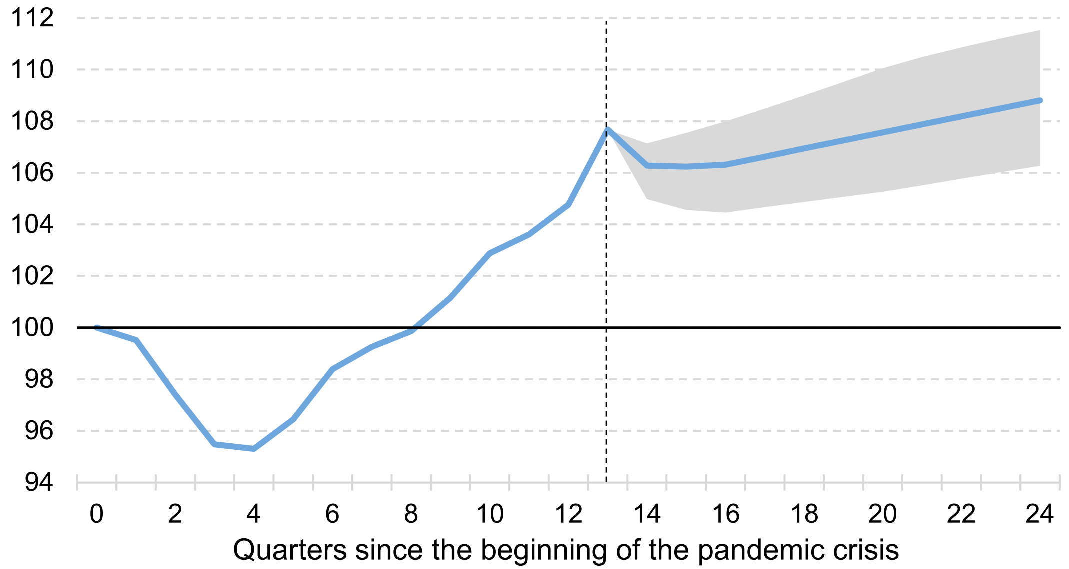
Executive Summary (3)

- Historical data show London's economy recovered to pre-pandemic levels by late 2021 and continued to grow strongly in 2022. Under the Gradual economic recovery scenario, London's GVA is set for a bumpy path in the coming quarters but avoids recession.
- Under the Recession, slow recovery scenario, weak incomes, high interest rates and financial sector turbulence push growth into reverse. Our fast recovery scenario sees strong jobs, high confidence and pent-up savings prevent slower output growth.
- Our scenarios all see job growth pulling back sharply from the record surge of Q1 2023. Our baseline sees a period of stagnation before recovering in 2024, our upside scenario recovers sooner, while our downside scenario sees a longer contraction.
- The trajectories in the figures are for the Gradual economic recovery scenario, with shaded areas for the scenario range.

Shape of the output recovery (index)



Shape of the employment recovery (index)



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Outline

1. Scenario assumptions
2. Medium-term scenario projections
3. Long-term scenario projections
4. Methodology and back series

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Ability to absorb shocks for households, businesses and government

Scenario 1: Fast economic recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
Inflation comes back under control quickly and interest rates do not have to rise further. The pound holds up due to high interest rates. Energy and food prices ease quickly. London’s stronger aggregate incomes compared to the rest of the UK offer a buffer against inflation as richer households spend more of their pandemic savings. Better trends in London business confidence than UK averages see firms make minimal cuts to hiring and investment. Financial sector turbulence fades with minimal impact on UK banks and lending. The impact of house price falls is moderated by the improvement in affordability.	Inflation takes time to come back down, and a weaker pound raises imported prices further despite rising interest rates. Energy and food prices ease slowly in 2023. High average incomes and optimistic households help London do better than other regions, but consumption slows amid some precautionary saving. Still-high costs and slowing demand prompt businesses to moderate hiring and investment, but job growth resumes in 2024. Global financial sector turbulence exerts some impact on UK banks, slowing lending. Falling house prices dent housing wealth, further dampening spending slightly.	Monetary policy struggles to control inflation, and high inflation expectations are ingrained. Sterling falls as UK prospects lag other countries. Energy and food remain costly. Staple prices rise faster in London than the rest of the UK. The drag on real incomes is hardest for low-income Londoners, who also have the highest propensity to consume. High costs, high interest rates, and tighter credit conditions mean businesses cut back on investment and hiring plans across 2023. Further risky bank failures depress the global financial system, tightening credit sharply. House prices drop, offsetting high-income households’ gains from a savings cushion.

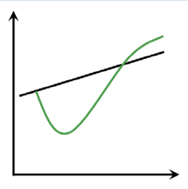
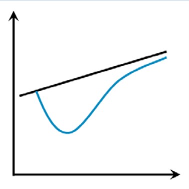
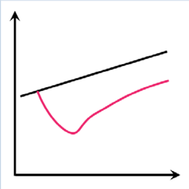
The policy environment and its impact on households and businesses

Scenario 1: Fast economic recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
Fiscal support eases just as the cost of living comes under control. A strong labour market means most consumers stay afloat by using savings or manageable cutbacks.	Fiscal support largely runs out as costs remain high. While some households fall into financial precariousness, spending on non-essentials slows rather than falling sharply.	Reduced fiscal support cuts incomes for the worst-hit households as rising interest rates create a debt overhang. Many consumers have to cut spending, even on essentials.
The Bank of England effectively combats inflation in the medium term with interest rate hikes, with inflation slowing sharply from mid-2023.	Still-high food costs and a growing cost impact from wage growth makes it harder for the Bank of England to control inflation despite rate hikes well into 2023. Tight policy brings inflation under 5% by early 2024.	The Bank of England is forced to hike interest rates aggressively to combat slow-falling global food prices and increasing wage pressure, but the impact is still hardly felt until late 2023 or early 2024.
Starting from a tight labour market means monetary tightening has a mild jobs impact.	Rapid tightening of macro policy slows job growth. But the labour market recovers to long-term average growth rates by 2024.	Recession and tight borrowing conditions keep labour demand low for some time.
Productivity improves in the medium term, pushing London back to pre-COVID trend growth. As a result, there is limited medium-term and no long-term economic scarring.	Some economic scarring emerges in the medium and long term. Productivity growth is steady in the medium term.	Another recession, persistent inflation and a slow recovery mean significant scarring. Productivity stagnates in the medium term.

Updated key assumptions for other drivers

Scenario 1: Fast economic recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
Despite geopolitical tensions, global mismatches between supply and demand largely disappear in the medium term.	Wider geopolitical tensions mean some limited supply chain disruptions, raising import cost volatility.	Geopolitical tensions generate a fragmented global economic and technology system, lowering long-term productivity.
Over the long term, the CAZ's recovery and resumed net inward migration avoid skill or geographic labour mismatches.	Economic restructuring means skill and geographic mismatches in the job market slightly slow the recovery.	Migration policy uncertainty and a slow post-pandemic restructuring mean job market mismatches that cut long-term growth.
UK and EU continue to resolve any arising trade relations issues. This mitigates the effects of UK exit from the Single Market.	UK and EU manage their remaining differences, but Single Market exit requires some restructuring of London's economy.	UK-EU disputes persist, raising barriers to trade and cutting trade flows. This hits long-run growth, amid significant restructuring.
UK energy markets diversify rapidly and next winter proves mild on average, limiting disruption from further gas supply crunches.	The UK partly mitigates disruption from gas supply cuts due to the war in Ukraine, but domestic energy bills are high for some time.	Limited gas reserves across Europe and a harsh winter bring energy costs back up in late 2023.
London's specialisation in emerging sectors allows it to capitalise on future growth and the CAZ remains a hub of economic activity. London reaps agglomeration economies.	There is some pressure on jobs in arts, hospitality, and retail in the CAZ, but the area remains attractive to business and continues to reap agglomeration economies.	There are job losses in many sectors in the CAZ. The cumulative effect means that the area becomes less attractive to business and reaps fewer agglomeration economies.

Long-term GVA convergence assumptions

Scenario 1: Fast economic recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
London’s economy returns to its pre-COVID trend growth (rate and level) in the medium to long term (within around five years). There is limited economic scarring in the medium term and none in the long term. 	London’s economy closes some of the gap from pre-COVID trends, but remains permanently below those levels (after 10+ years) as there is a degree of economic scarring in the medium and long term. 	Persistent economic scarring means that in the long term the economy will see a slow recovery and London’s output increasingly diverges from pre-pandemic trend levels. 

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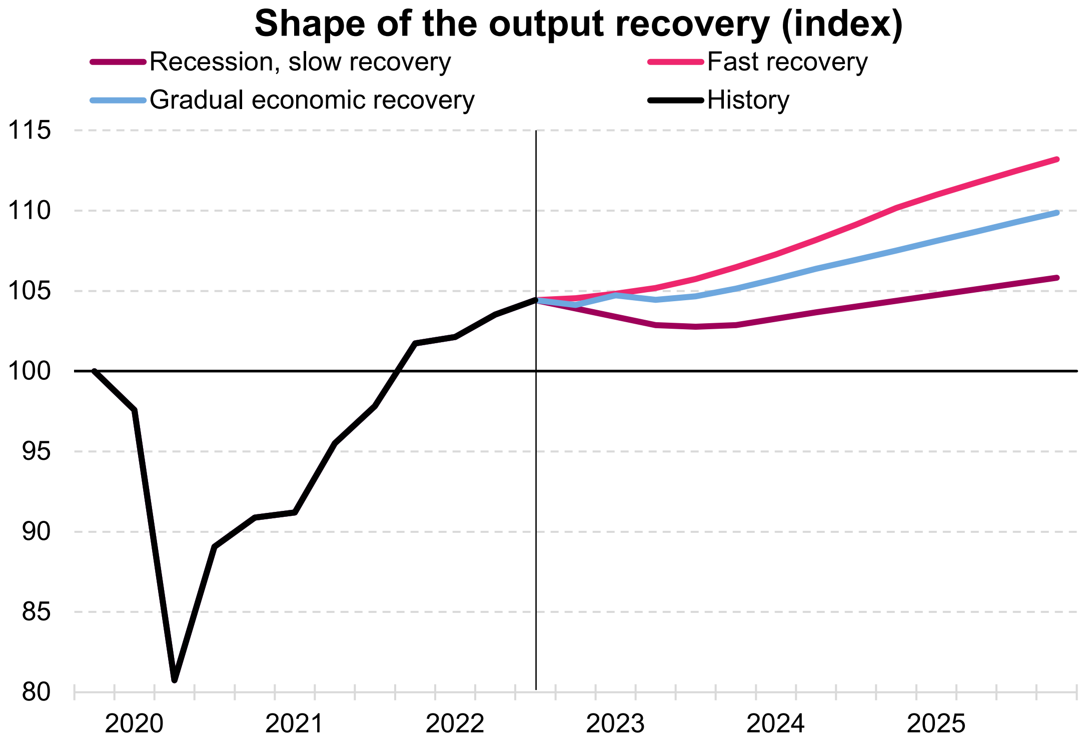
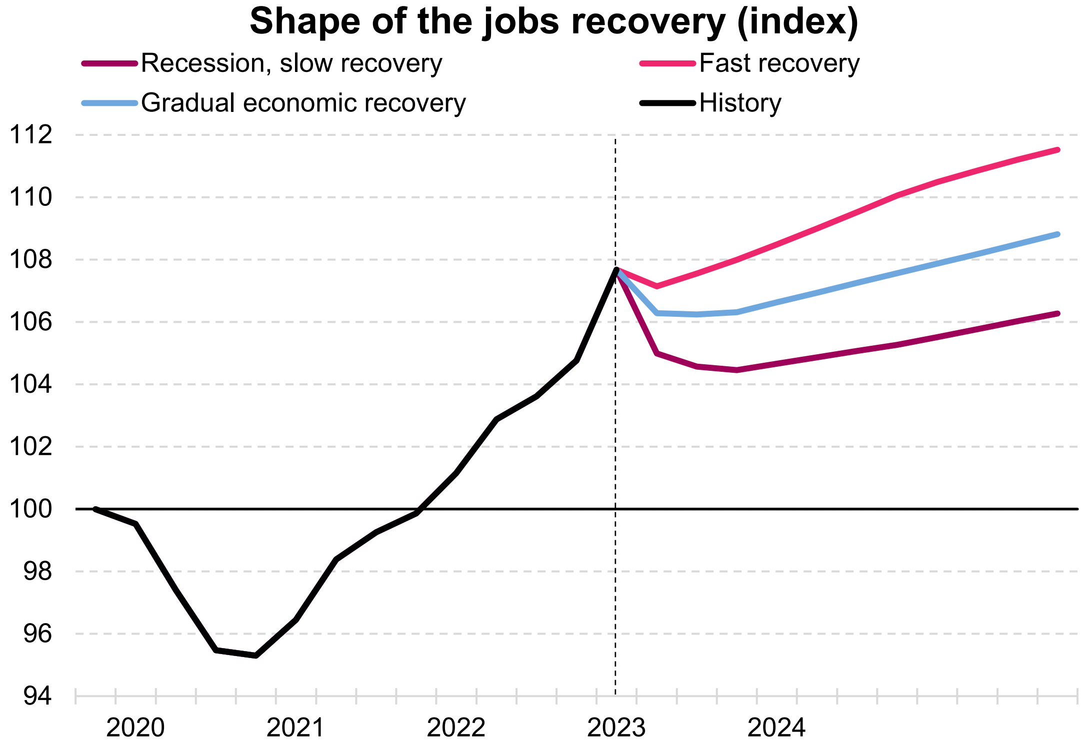
The overall storyline behind Recession and gradual recovery scenario

Q4 2022 to Q2 2023 (Volatile growth)	Q3 2023 to Q4 2024 (Normalisation)	2025 and beyond (New Normal)
• The recovery stutters as high inflation, squeezed real incomes and swings in public spending buffet the economy from contraction to expansion and back again. • Rising interest rates put pressure on goods sectors and the property market, dragging on Manufacturing, Construction and Real estate. • The Financial sector also faces a slow period as global turbulence prompts reduced activity. • Consumer-facing sectors involved in retail, entertainment and hospitality struggle as while average incomes rise, those at the bottom of the scale come under sustained pressure. • Use of public transport remains below pre-pandemic levels as a transition to hybrid working continues. • The return of visitors and tourists is mostly complete, providing some support to retail and recreation-focused sectors. • The CAZ begins to undergo structural changes as firms adjust to post-pandemic trends like widespread hybrid working.	• Inflation subsides, but interest rate rises continue to drag on aggregate demand. • The tension between improving real incomes and the delayed impact of monetary policy means a steady glide back towards more normal growth rates. • Consumer-facing sectors recover more slowly, as incomes take time to recover. • London's export-oriented, knowledge sector services like IT, Professional services and Finance improve faster and earlier. This drives slightly accelerated output growth in late 2024. • Tighter lending conditions and a normalisation from very rapid job growth mean that hiring slows near to standstill in late 2023. Growth returns to long-term averages in 2024. • Uncertainty and high interest rates limit the investment recovery.	• The economy returns to more normal growth rates as inflation slows, monetary policy returns to a more neutral footing and the pressure on incomes eases. • The pace of recovery depends on 1) control of inflation without scarring demand, 2) the resilience of London's households, 3) London's capacity to attract investment, 4) the pace of fiscal consolidation and 5) global context. • Following the withdrawal of fiscal support there is some shake-out of unviable businesses. • Investment (and recapitalisations) will be key to supporting companies which survived the pandemic but remain weak. • Jobs recovery will continue to advance but there is disproportionate medium-term damage from the pandemic for disadvantaged groups such as young people and ethnic minorities. • The fact that key inflation pressures have come from essential goods and service prices also tends to widen existing inequalities.

Medium-term scenario projections for London





Source: GLA Economics; Note: Index of 100 = pre-pandemic level.

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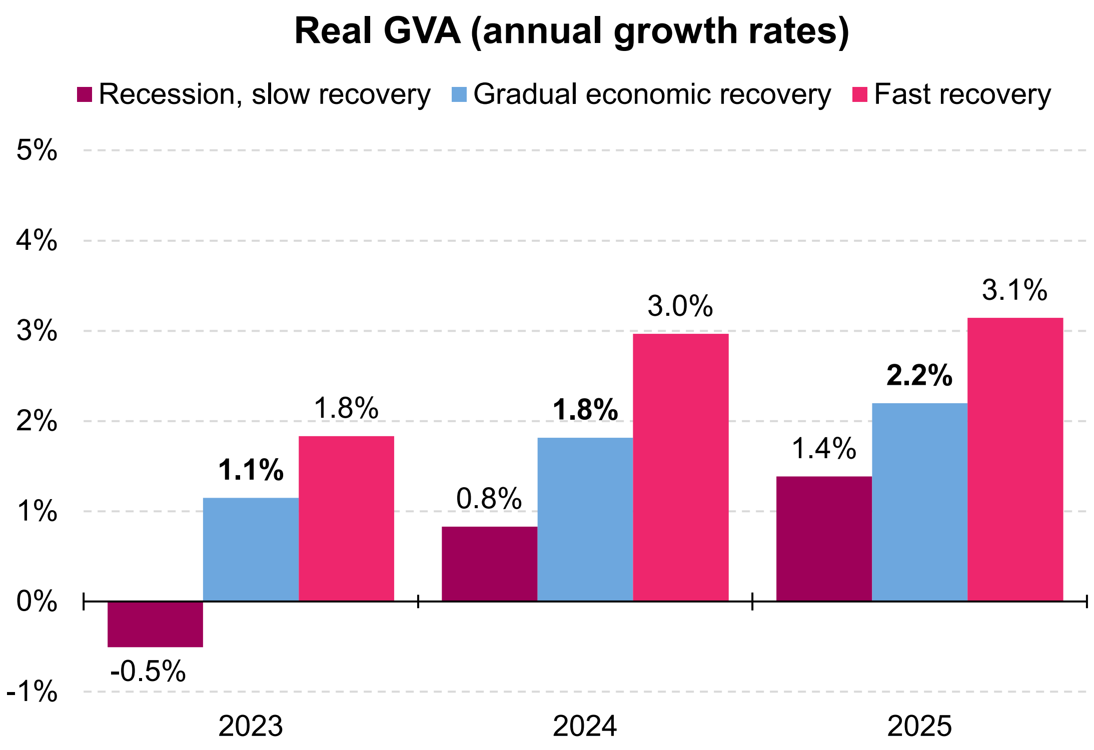
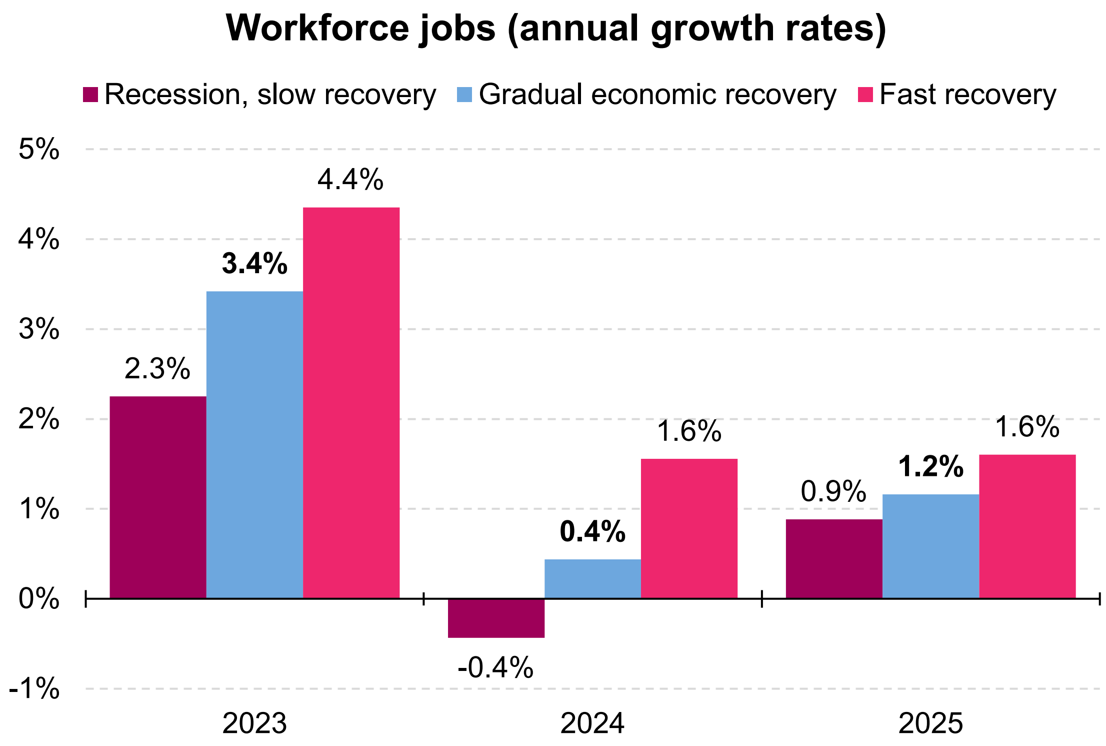
Medium-term scenario projections: annual growth rates





Source: GLA Economics

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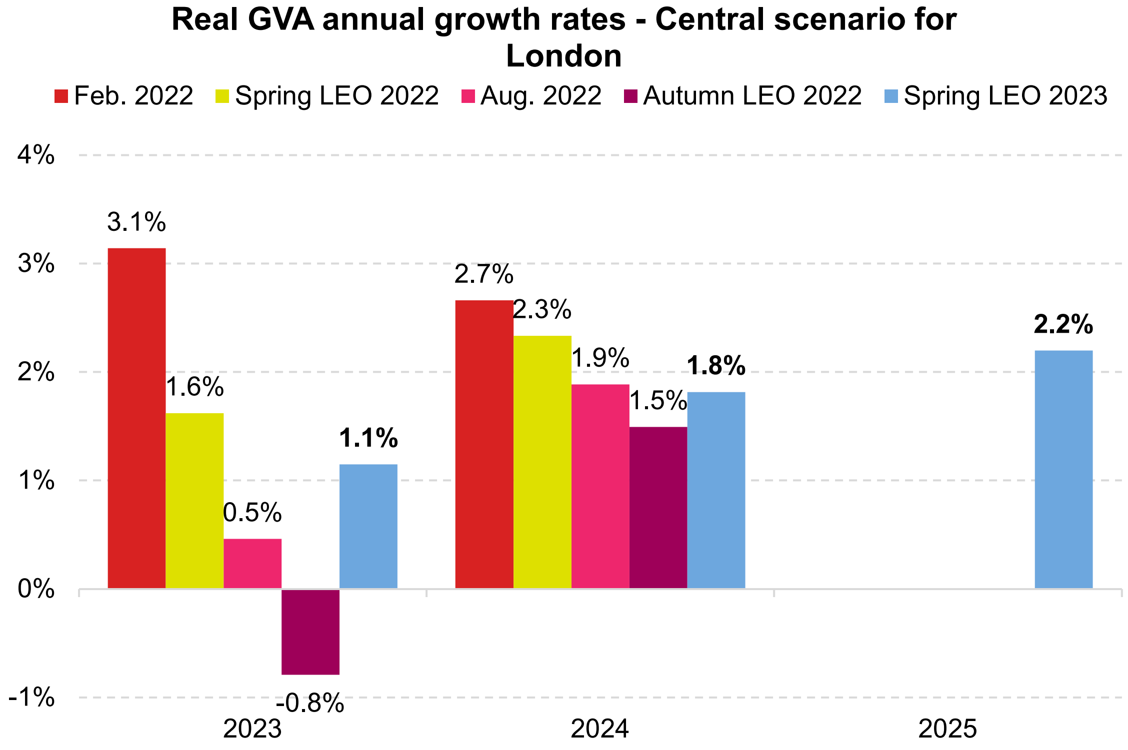
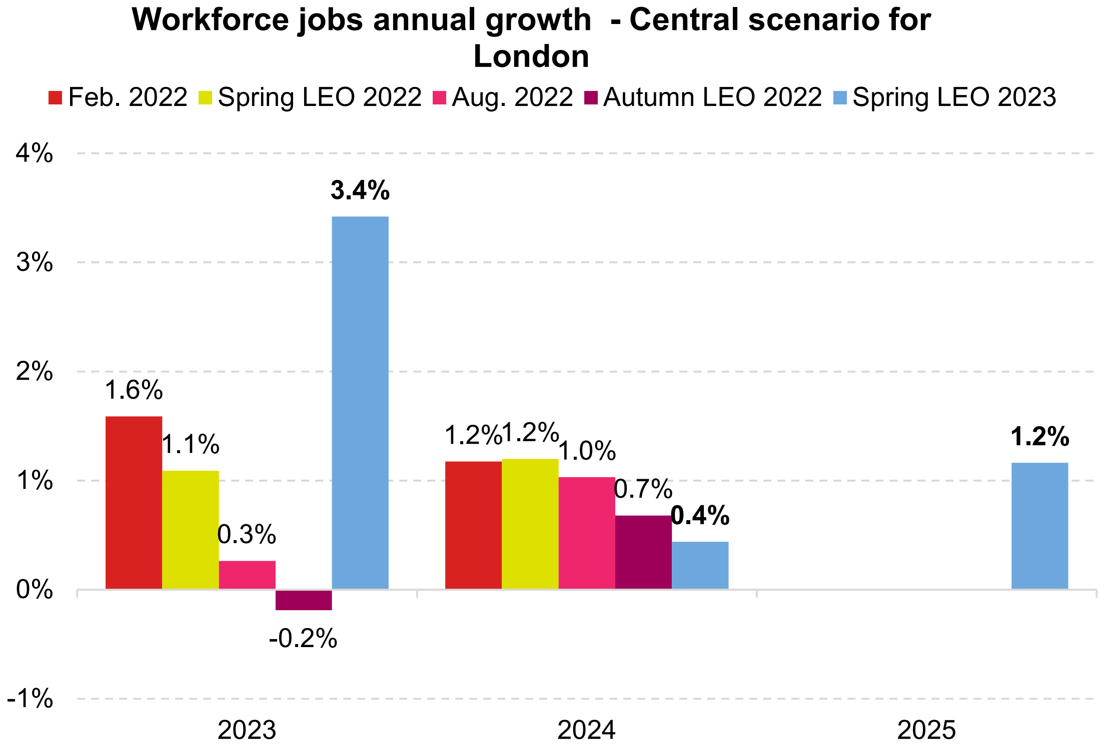
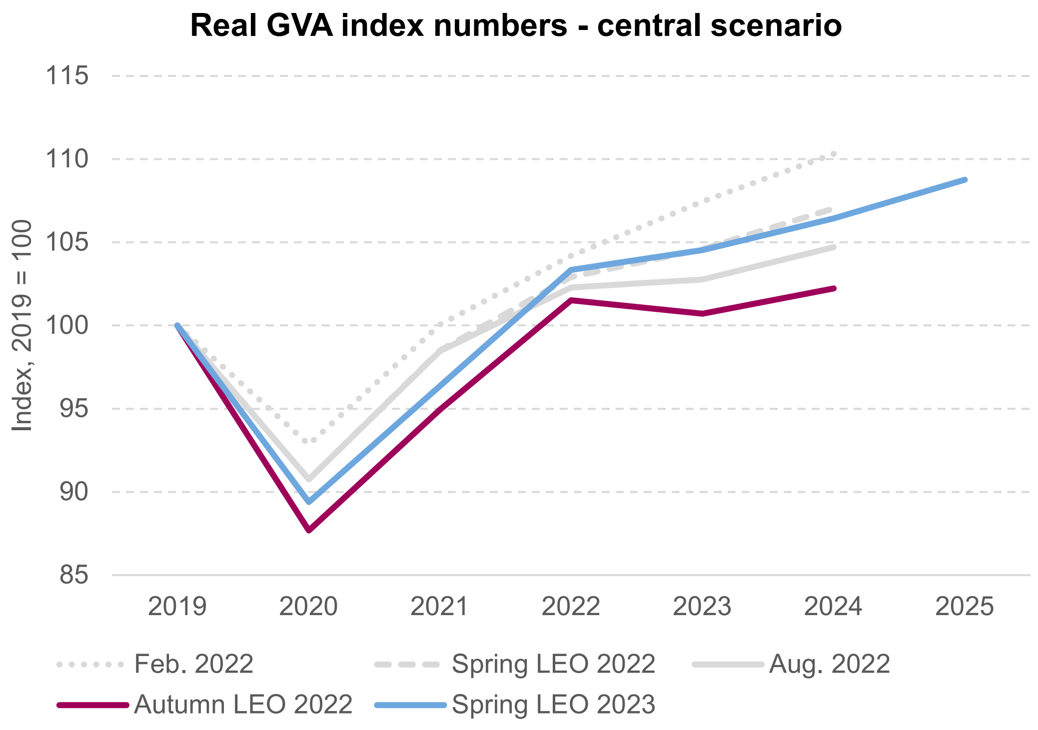
Comparison of successive Gradual recovery scenarios across outputs (1)

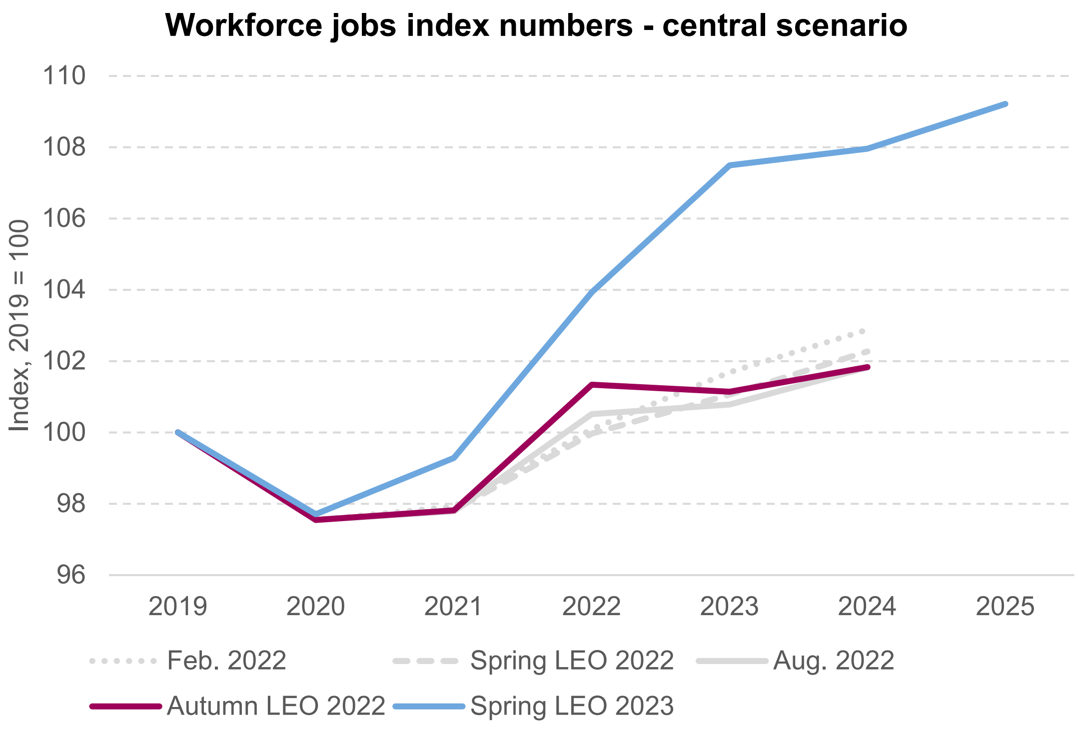




Source: GLA Economics

Comparison of successive Gradual recovery scenarios across outputs (2)





Source: GLA Economics estimates

London sectors: GVA and jobs growth projections in 2023 and 2024

Real GVA annual growth rate	2023	2024
Sector	**%**	**%**
Agriculture, forestry and fishing	**0.1**	**1.0**
Mining and quarrying	**4.7**	**2.3**
Manufacturing	**-2.2**	**1.1**
Electricity, gas, steam and air-conditioning supply	**2.0**	**2.8**
Water supply; sewerage and waste management	**0.7**	**2.8**
Construction	**-1.1**	**1.5**
Wholesale and retail trade; repair of motor vehicles	**1.8**	**1.6**
Transportation and storage	**-2.6**	**2.4**
Accommodation and food service activities	**4.9**	**1.5**
Information and communication	**3.8**	**2.6**
Financial and insurance activities	**0.9**	**2.2**
Real estate activities	**-1.1**	**2.4**
Professional, scientific and technical activities	**1.7**	**2.6**
Administrative and support service activities	**2.1**	**1.5**
Public administration and defence	**2.2**	**-0.6**
Education	**-1.1**	**-0.4**
Human health and social work activities	**1.4**	**-0.5**
Arts, entertainment and recreation	**1.8**	**1.6**
Other service activities	**-1.3**	**1.9**
Activities of households	**-2.6**	**1.9**

Workforce jobs annual growth rate	2023	2024
Sector	**%**	**%**
Agriculture, forestry and fishing	**23.1**	**0.1**
Mining and quarrying	**0.0**	**0.8**
Manufacturing	**-1.2**	**0.4**
Electricity, gas, steam and air-conditioning supply	**14.5**	**1.1**
Water supply; sewerage and waste management	**-4.6**	**1.1**
Construction	**-0.4**	**0.3**
Wholesale and retail trade; repair of motor vehicles	**0.6**	**0.8**
Transportation and storage	**5.0**	**1.2**
Accommodation and food service activities	**8.4**	**0.6**
Information and communication	**5.0**	**1.7**
Financial and insurance activities	**7.7**	**0.7**
Real estate activities	**6.8**	**0.6**
Professional, scientific and technical activities	**3.2**	**1.7**
Administrative and support service activities	**5.7**	**0.9**
Public administration and defence	**1.7**	**-1.9**
Education	**-4.5**	**-1.7**
Human health and social work activities	**4.1**	**-1.7**
Arts, entertainment and recreation	**-3.4**	**0.8**
Other service activities	**15.1**	**-0.8**
Activities of households	**-9.4**	**10.0**

Source: GLA Economics estimates – 'Gradual economic recovery' scenario

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Key assumptions behind the long-term projections

	NO-COVID / Counterfactual	Scenario 1: Fast recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
GVA level in 2025	As estimated by GLAE in April 2020 forecasts	As projected in medium-term scenario 1	As projected in medium-term scenario 2	As projected in medium-term scenario 3
Time counterfactual GVA level is reached	NA	2027	Not within the ten-year horizon	Not within the ten-year horizon
GVA Growth rate in 2033	Estimated by assuming convergence (linear or exp) from 2022 growth rate to steady state by 2041	2.9% (long-term London trend growth rate, convergence towards UK steady state does not start in the 2020s).	As in counterfactual (converging towards 2% from above)	As in counterfactual (converging towards 2% from below)
GVA level in 2033	Projected in line with the above assumptions	Higher than the counterfactual	Steadies at just over 4% below counterfactual (reflecting macroeconomic scarring from two recessions in succession)	Counterfactual level less nearly 9% (reflecting combination of microeconomic and macroeconomic scarring from crises, plus Brexit)
GVA growth rate in 2042 (steady state)	1.5% per year (based on OBR long-term / steady-state projection)	NA	1.5% per year	1.5% per year

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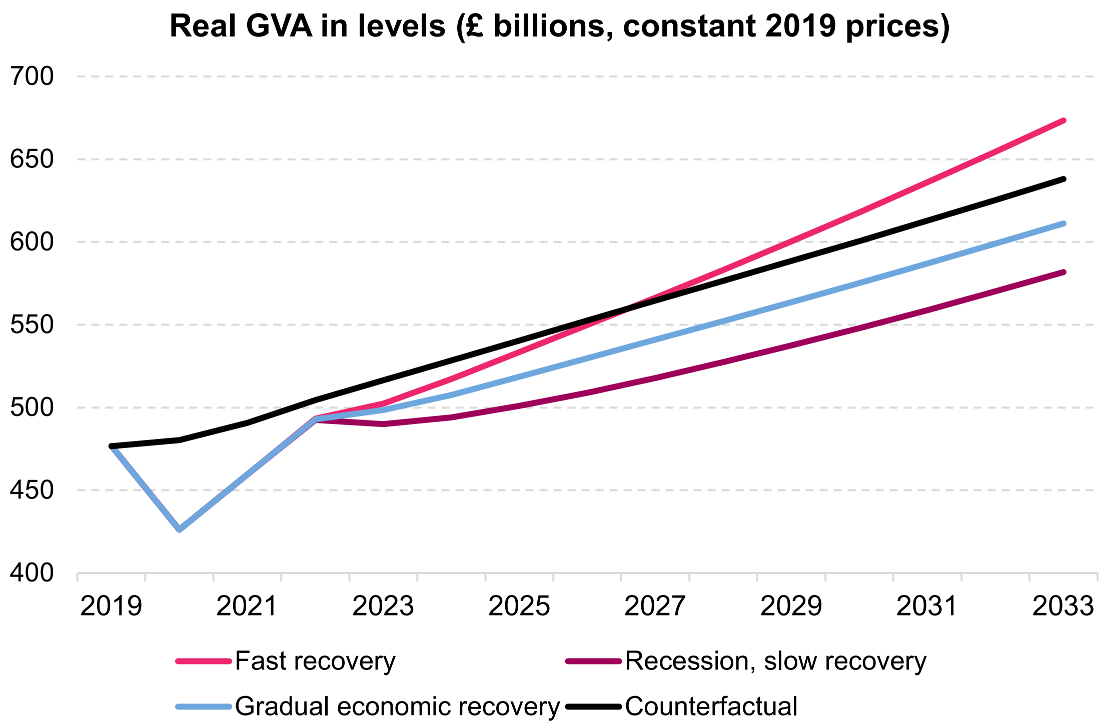
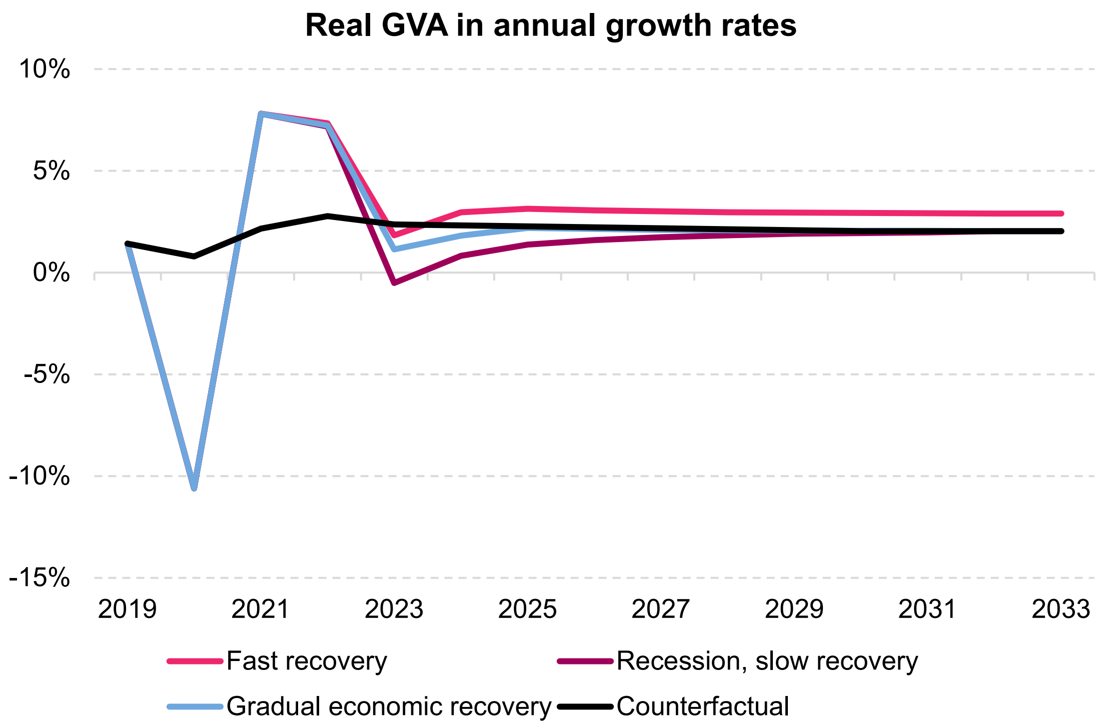
Long-term scenario projections for London



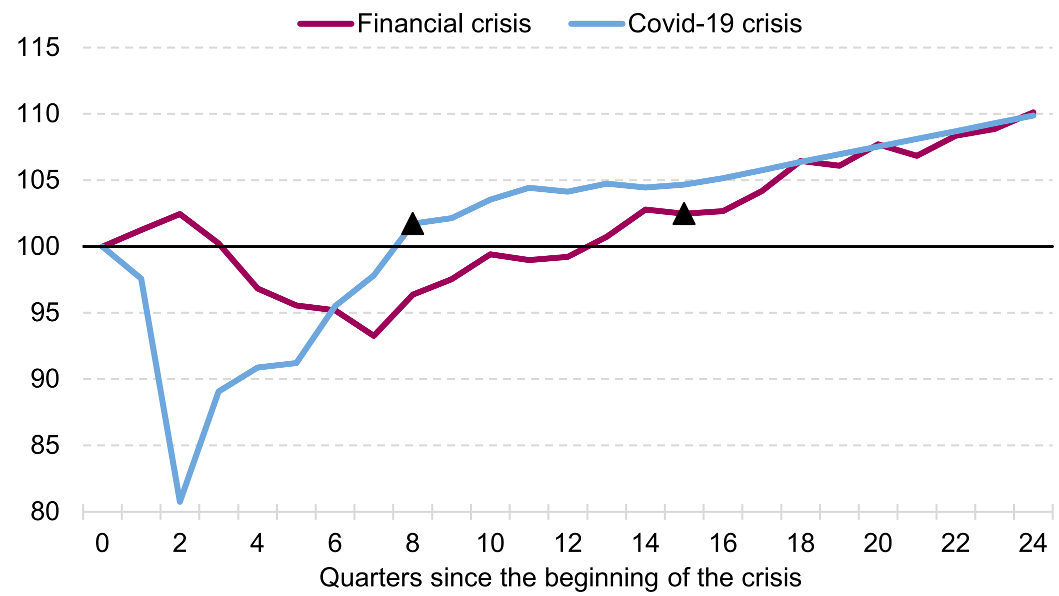


Source: GLA Economics

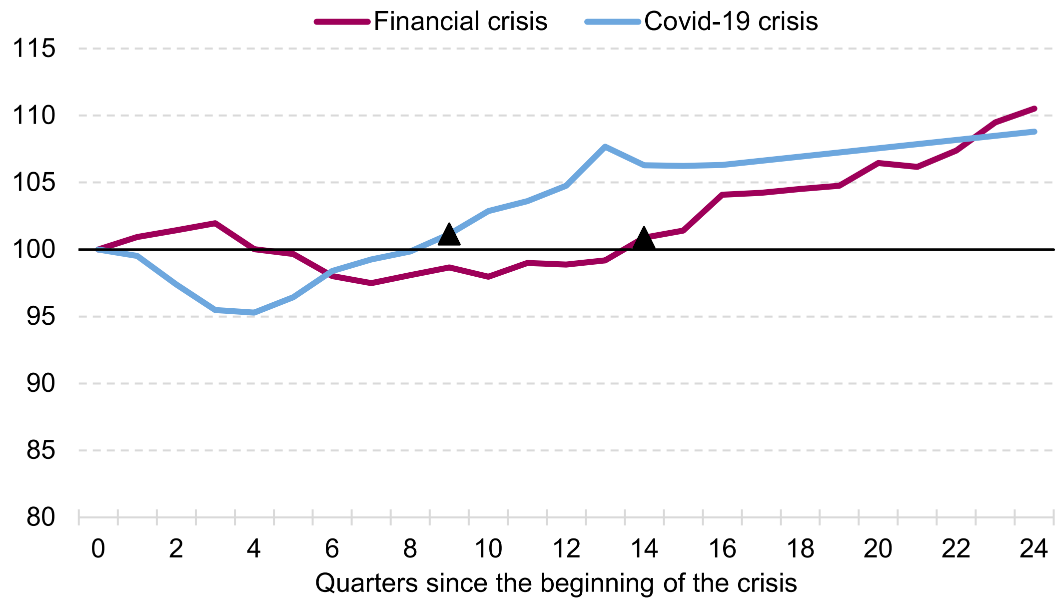
Comparison with the financial crisis

- Despite a deeper and more rapid fall, London's output rebounded more quickly from the pandemic than from the financial crisis. However, the cost of living crisis is now dragging the recovery back.
- Employment also shrank more rapidly during the pandemic. While the time to recover was faster than taken after the financial crisis, the greater loss of jobs in a weak labour market may create economic scarring, as workers lose contact with the labour market and become inactive.

Shape of the output recovery (index)



Shape of the employment recovery (index)



Source: GLA Economics

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Summary of GVA annual growth rates in selected years

Real GVA – annual growth rates (selected years)

Year	Scenario 1: Fast recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
	GVA	**GVA**	**GVA**
2023	1.8%	1.1%	-0.5%
2024	3.0%	1.8%	0.8%
2025	3.1%	2.2%	1.4%
2030	2.9%	2.1%	1.9%

Source: GLA Economics

Summary of GVA in levels in selected years

Real GVA – £m 2019 prices (selected years)

Year	Scenario 1: Fast recovery	Scenario 2: Gradual economic recovery	Scenario 3: Recession, slow recovery
	GVA	GVA	GVA
2023	502,350	498,470	490,067
2024	517,246	507,523	494,140
2025	533,502	518,675	500,991
2030	618,006	575,232	547,999

Source: GLA Economics

Real GVA quarterly levels over the forecasting period – Gradual recovery scenario

Real GVA – levels, £m 2019 prices

Q1 2022	Q2 2022	Q3 2022	Q4 2022
121,506	123,175	124,248	123,880
Q1 2023	**Q2 2023**	**Q3 2023**	**Q4 2023**
124,605	124,257	124,526	125,083
Q1 2024	**Q2 2024**	**Q3 2024**	**Q4 2024**
125,805	126,554	127,238	127,926
Q1 2025	**Q2 2025**	**Q3 2025**	**Q4 2025**
128,619	129,316	130,017	130,722

Source: GLA Economics

Workforce jobs quarterly levels over the forecasting period – Gradual recovery scenario

Workforce jobs – levels, thousands

Q1 2022	Q2 2022	Q3 2022	Q4 2022
6,152	6,257	6,302	6,372
Q1 2023	**Q2 2023**	**Q3 2023**	**Q4 2023**
6,549	6,464	6,461	6,466
Q1 2024	**Q2 2024**	**Q3 2024**	**Q4 2024**
6,485	6,504	6,523	6,542
Q1 2025	**Q2 2025**	**Q3 2025**	**Q4 2025**
6,561	6,580	6,599	6,618

Source: GLA Economics

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Summary of methodology

- Quarterly ONS UK output data is available to Q1 2023 for the UK and to Q3 2022 for London by sector. Q4 2022 and Q1 2023 London output tracks UK trends with modifications in line with London-specific indicators like business and consumer confidence.
- Quarterly jobs data by sector available for London and the UK to Q1 2023. Payrolled employee jobs estimates for London and the UK inform jobs forecast.
- Development of scenarios considers modelling of published and non-published external forecasts. For this iteration, it pays particular attention to the latest estimates by the Office for Budget Responsibility (OBR) and the Bank of England. The modelling also builds on previous versions of GLAE scenarios.
- Sector level modelling reflects the disproportionate sectoral effects of the current crises. Profiles for sectors such as arts and hospitality will balance a catch-up effect from the disproportionate impact of the pandemic with the fresh impact of dampened consumer demand. The impact of high interest rates will dampen medium-term growth in goods- and property-oriented sectors.
- The subsequent recovery glides towards the longer-term paths (explained in earlier slides) expected for each London scenario. Specifically, for the Gradual economic recovery scenario there is an assumption that output returns near to the counterfactual scenario.

Back series

- Some of this data has been estimated by GLA Economics. For output, ONS GVA data to 2021 is spliced with ONS quarterly GDP data to Q3 2022
- In the absence of other data, GVA and GDP data are taken as equivalent, and so the effects of taxes and subsidies are ignored (GVA = GDP + subsidies – taxes)
- ONS Workforce Jobs data is available to Q1 2023.
- An ONS nowcasting GVA series for London was previously published, but this experimental series is currently suspended.

Real GVA – levels, £m 2019 prices

Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022
118,973	116,097	96,072	105,966	108,111	108,508	113,636	116,378	121,029	121,506	123,175	124,248

Workforce jobs – levels, thousands

Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021	Q1 2022	Q2 2022	Q3 2022	Q4 2022	Q1 2023
6,082	6,053	5,924	5,807	5,796	5,866	5,984	6,037	6,074	6,152	6,257	6,302	6,372	6,549

Source: ONS, GLA Economics