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UK economy grows modestly in 2017 as global economic growth speeds up

By **Gordon Douglass,** Supervisory Economist and **Eduardo Orellana Palma**, Economist

The UK's economy grew throughout 2017 at a rate of 1.7 per cent. This is according to the Office for National Statistics' (ONS) second estimate of Q4 2017 GDP published in February 2018, though this is based on incomplete data. The annual rate was slightly slower than the 1.9 per cent seen over 2016 and was the weakest expansion in the last five years as Figure 1 shows. Additionally, the UK's rate of economic growth has slowed for the third year in a row, against the observed trend in other advanced economies such as Germany or the US where the rate of output growth remained solid during the same period.

Looking specifically at the final quarter of the year, the UK economy grew a bit more weakly than the rates seen in the previous quarter. Output grew at a quarterly rate of 0.4 per cent in Q4 2017. This compared with the expansions of 0.5 per cent recorded for Q3, 0.3 per cent for Q2 and 0.2 per cent recorded for Q1. However, for the first time in the last three years, all the UK quarterly rates within the year have been lower than both the US and the Eurozone quarterly rates for the same

Latest news...

Consultation – an economy that works for all Londoners

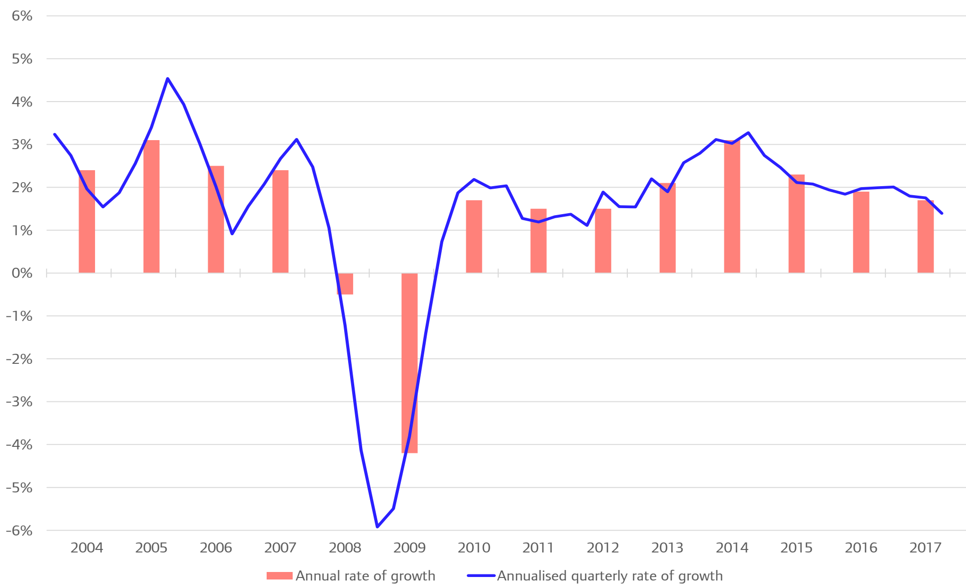
The Mayor launched his draft Economic Development strategy in December. It sets out his plans to grow London's economy, support businesses, boost innovation and create a city that works for all. He wants to know what you think about these plans and hear your thoughts on how we can protect jobs and prosperity in these testing times.

The draft Economic Development strategy has three main goals: **Opportunities** for everyone to benefit from all our city offers; **Growth** – ensuring our economy will continue to thrive and is open to business; **Innovation** – to make London a world leader in technology and a hub of new ideas and creativity.

Have your say before the consultation closes on 13 March 2018.

Figure 1: UK real annual GDP growth (2004-2017)

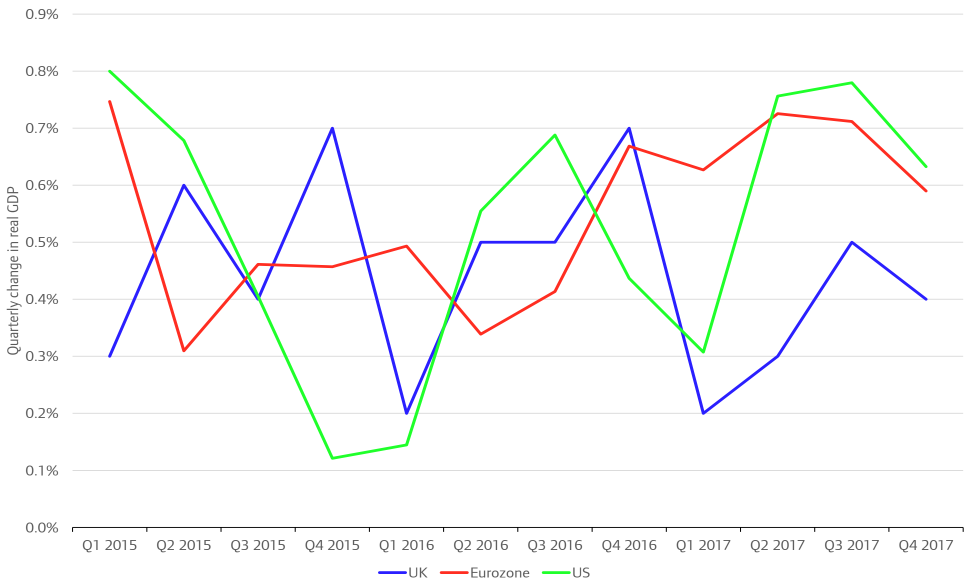
Source: ONS



year (see Figure 2). Looking at the sector composition of UK GDP, growth in the final quarter of 2017 was uneven. While the services and production sectors saw growth, output growth in the construction sector was negative for the third quarter in a row. Still, the business services and finance sector, a particularly important sector to London's economy, saw its fastest increase in three years with the quarterly rate of growth standing at 0.9 per cent in Q4 2017.

Figure 2: Real quarterly GDP growth for the UK, US and Eurozone (2015-2017)

Source: ONS, Eurostat and US Bureau of Economic Analysis



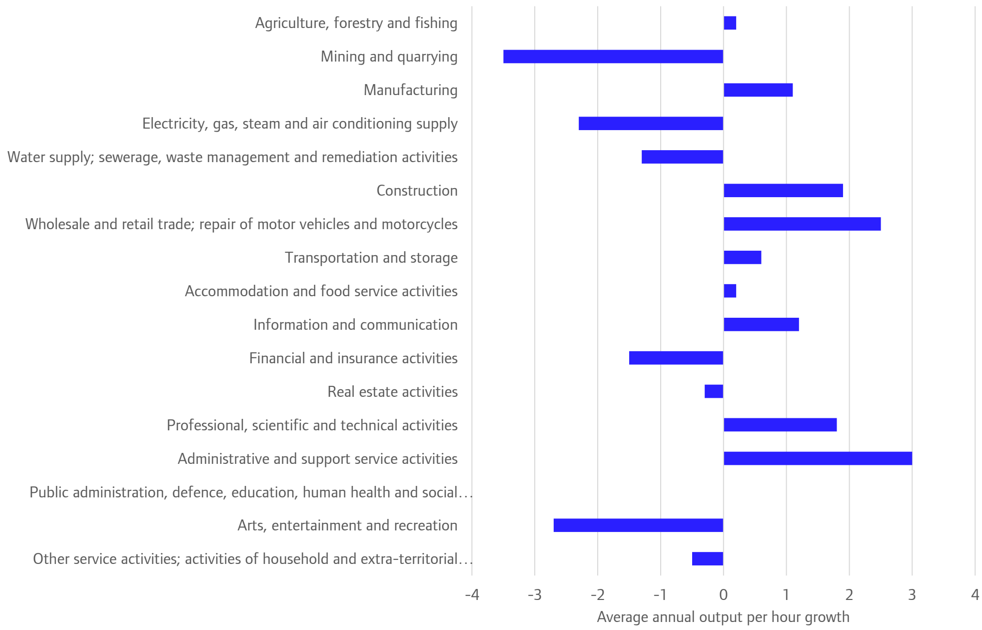
Outside the UK, the preliminary estimate of GDP in 2017 for the US and the flash estimate for the Eurozone reported annual average growth rates of 2.3 per cent and 2.5 per cent respectively. US real GDP growth was 0.8 percentage points higher compared to 2016 (1.5 per cent). At the same time, the Eurozone registered its strongest annual performance in a decade led by a 3.1 per cent growth rate in Spain and supported by a continued decrease of the unemployment rates across most countries. It is also important to highlight that Germany (the largest economy in the Eurozone) reached its highest annual growth rate since 2011 in 2017 (2.2 per cent). While, with regards to Japan, the rate of economic growth picked up by 0.7 percentage points to 1.6 per cent in 2017, which was the fastest growth rate since 2013.

London's productivity continues to outshine the rest of the UK

An often-debated puzzle about the recent performance of the UK economy since the financial crisis is that its moderate growth in output has been combined with strong employment growth resulting in a relatively historically poor productivity performance (although ONS data showed that this picked up slightly in the second half of 2017). Examining this puzzle, the ONS has recently published data looking at UK productivity and also experimental statistics looking at regional productivity. As can be seen in Figure 3, this data showed that there had been a wide variation in the growth in output per hour worked in the different sectors of the economy. When these results are combined with the growth in employment by sector of the UK economy, the ONS concluded that the data suggests "that changes in the aggregate mix of activity in the UK economy – as well as lower productivity growth in telecommunications, manufacturing and finance industries – account for a large proportion of the UK's recent productivity slowdown".

Figure 3: UK annualised output per hour growth by industrial sector; seasonally adjusted, Q3 2009 to Q3 2017

Source: ONS



Meanwhile, in terms of UK geographic areas, the ONS observed that "regional labour productivity suggests wide differences across the UK: the five sub-regions of London made up the top five areas by labour productivity, while predominantly rural areas in England and Wales had among the lowest levels of labour productivity in 2016". They noted at the London level, as a whole, gross value added per hour worked was 33 per cent above the UK average. The only other region with productivity above the UK average was the South East of England which was 6 per cent above the UK average (see Figure 4).

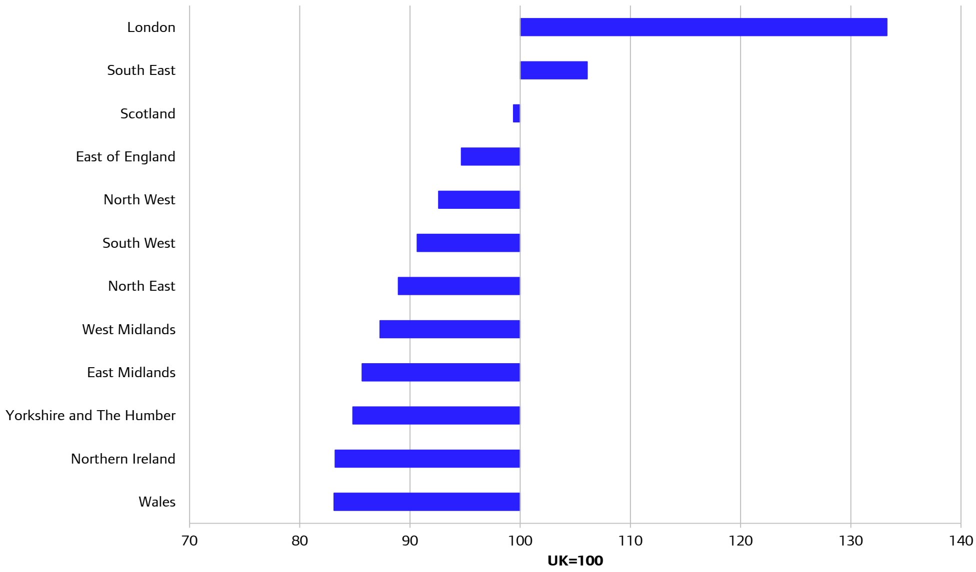


Figure 4: Labour productivity (gross value added per hour worked) by NUTS1 region, unsmoothed, current prices, 2016

Source: ONS

Bank of England indicates that interest rate rises are on the horizon

Looking forward at the prospects for the UK economy in the coming three years, the Bank of England published their latest Inflation Report in February. In this they stated that over their forecast period "GDP growth is projected to average around 1¾% …, supported by the strength in global growth, a lessening drag from the fiscal consolidation, accommodative financial conditions and a modest recovery in household real income growth". They noted that the risks to this forecast are on the upside (i.e. the risks are more balanced that output will actually be higher than forecast) with this "stemming from the possibility of a greater boost from global demand". This rate of growth although "modest by historical standards … is still expected to exceed the diminished rate of supply growth". They consequently think that if the economy does grow at this rate, then "monetary policy would need to be tightened somewhat earlier and by a somewhat greater extent over the forecast period" than previously thought.

Interest rate rises are also expected in a number of countries in the coming year, in part due to concerns of higher inflation as world growth remains strong. This expectation of rising interest rates had a knock-on effect on global stock markets in February with falls seen in all major markets in the beginning of the month, although since then there have been rebounds in the markets. Still, it was noticeable that both the Dow Jones Industrial Average and the S&P 500 entered correction territory (a decline of 10 per cent) for the week ending 10 February, with them seeing their worst weekly losses since January 2016. While in the UK the FTSE 100 saw a 5 per cent decline over the week.

Government Brexit forecasts show London likely to be less impacted than the UK as a whole

In February, forecasts produced by the Government on the impact on the UK and its nations and regions of various Brexit scenarios were seen by MPs. The forecasts showed that at the end of 15 years compared to what it would have been if the UK had stayed in the EU, UK GDP would be 2 per cent lower if it left the EU but remained in the single market; 5 per cent lower under a free trade deal; and 8 per cent lower under no deal. However, there was great variations between different parts of the UK with London forecast to fare least badly. For example, it is forecast if the UK remained in the single market London's economy would be 1 per cent lower (the joint least negative result with the South West) than if it had stayed in the EU; if the UK had a free trade deal with the EU instead, London's economy would be 2 per cent lower (again the joint least negative result with the South West) than under EU membership; and under no deal London's economy would be 3.5 per cent lower (the least negative result of any area of the UK).

These results for London compare somewhat similarly to results published by the Mayor of London in January, though that analysis only looked at the years up to 2030 among other likely modelling differences which are as yet unclear given the government's analysis has not yet been published. The results for the UK of the government's analysis were, however, more pessimistic than the results of the various scenarios in the analysis carried out for the Mayor. The government's analysis also looked at the impact on a number of sectors. For instance, it estimated that the negative impact for financial services may be around 5-10 per cent under the various scenarios; for business services between 0-6 per cent; and for retail and wholesale between 7-20 per cent. In contrast, for construction, it was 0 per cent.

As of yet, the final relationship between the UK and EU is unknown, which results in economic uncertainty. In this situation a number of surveys have been conducted into what business feels will be the outcome of Brexit, including a recent survey of over 2,500 senior European (including UK) business executives by FTI consulting. This found notwithstanding the current negotiating stances of both the EU and UK Government that 58 per cent of those surveyed believed the financial sector would retain its passporting rights. And in terms of surveyed UK financial companies, more than two-thirds thought passporting rights would be maintained. In general, the majority of those surveyed also felt the future relationship with the EU would maintain principles such as the free movement of people and oversight by the European Court of Justice.

Mixed economic signals for the London economy continue

The future economic environment remains somewhat uncertain with a mixed economic picture seen at the end of 2017 continuing into the first couple of months of 2018. So, figures from Visa showed that consumer spending in the UK declined in January. The credit card company said that falls in high street shopping and spending on transport led to its UK spending index showing a year-on-year drop of 1.2 per cent in January. This followed a decline of 1 per cent in December, with there being year-on-year falls in consumer spending for eight of the past nine months according to the index. Data from the ONS also supported this view of relative retail weakness with the ONS three-month on three-month measure of retail sales showing growth of just 0.1 per cent in January 2018. Commenting on these retail figures, Rhian Murphy, ONS Senior Statistician said "retail sales growth was broadly flat at the beginning of the New Year with the longer-term picture showing a continued slowdown in the sector. This can partly be attributed to a background of generally rising prices".

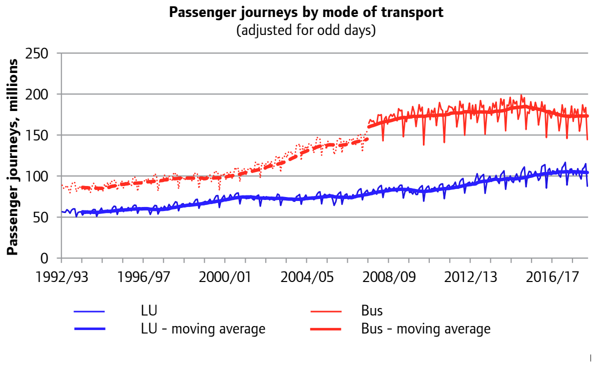
However, some surveys have given a more positive view of the economy. This includes the Bank of England's Agents' summary of business conditions - February 2018 update which highlighted a survey that found "that companies expected an average pay settlement rate of 3.1% in 2018". This would be above the current rate of inflation implying that real wages could start to rise again. Similarly, looking at London's office market, Knight Frank's Central London Quarterly for the final quarter of 2017 found that "take-up increased by 17% over the previous year, driven by technology, media and telecoms (TMT) occupiers and flexible working providers, who together accounted for almost half of all transactions in 2017". It also reported that "investment turnover for the final quarter was 45% above the long-term average" and remained popular with overseas buyers with "overseas capital account(ing) for 83% of all assets purchased during 2017". The London labour market also showed some strength with the unemployment rate staying steady at 5.0 per cent in the three months to December, unchanged on the previous quarter.

Given this mixed news, the economic picture remains cloudy for both London and the UK over the next few months but enough evidence exists to show their underlying strengths remain.

Economic indicators

Number of TfL passenger journeys declines

- A total of 232.2 million passenger journeys were registered between 10 December and 6 January, 66.6 million less than the previous period accounting for odd days. This large decline is a normal pattern during the Christmas period, period where the number of passenger journeys usually reaches its minimum during the year. 87.7 million of these journeys were Underground journeys and 144.5 million were bus journeys.
- The 12-months-moving average in the total number of passenger journeys declined from 277.8 million to 277.6 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).

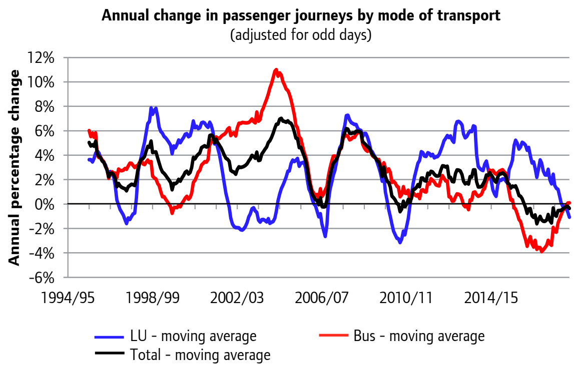


Source: Transport for London

Latest release: February 2018
Next release: March 2018

Contraction in passenger journeys deepens

- The moving average annual growth rate in the total number of passenger journeys fell to -0.4 per cent, down from -0.2 per cent in the previous two periods.
- The moving average annual growth rate of bus journeys remained at 0.1 per cent.
- In contrast, the moving average of Tube passenger journeys showed a significant decline, from -0.6 per cent to -1.1 per cent, the lowest rate since 2010-11.

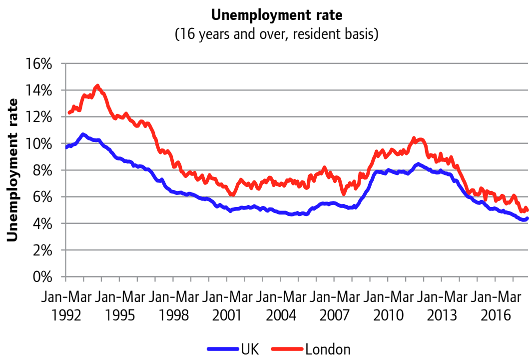


Source: Transport for London

Latest release: February 2018
Next release: March 2018

London's unemployment rate remains at 5.0 per cent in Q4 2017

- 245,800 residents aged over 16-years were unemployed in London for the last quarter of 2017; almost 9,000 persons fewer than the three-month period to November, but a 1,300 increase on Q3 2017.
- The unemployment rate in London remained unchanged at 5.0 per cent in the last quarter of the year, the joint lowest level for any quarter since the start of this series in Q1 1992.
- Meanwhile, the UK's unemployment rate increased slightly from 4.3 per cent in Q3 2017 to 4.4 per cent in Q4 2017.



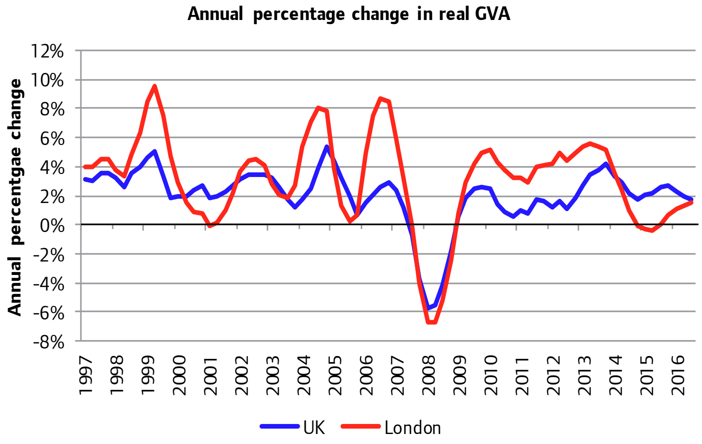
Source: ONS Labour Force Survey

Latest release: February 2018
Next release: March 2018

London's annual output growth reaches a two-year peak

- London's annual growth in output was 1.5 per cent in Q3 2017, 0.2 percentage points higher than Q2 2017, and the highest level for two years.
- Annual output growth in the UK slowed again to 1.7 per cent in Q3 2017, the weakest expansion in four years.
- From LET Issue 165 (May 2016), GLA Economics now reports our own GVA estimates for London and ONS data for the UK.

Latest release: January 2018
Next release: May 2018

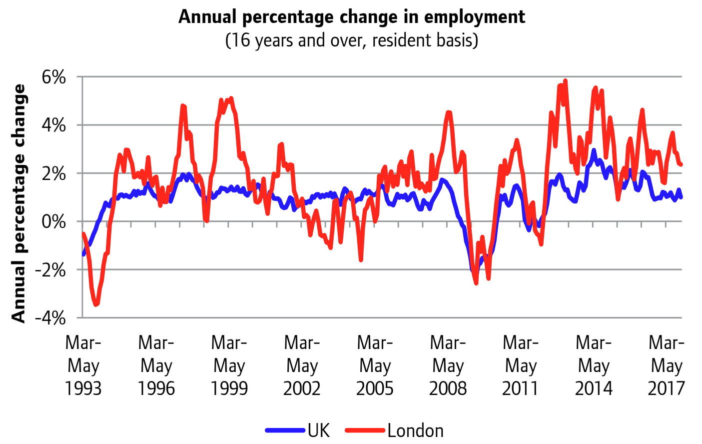


Source: GLA Economics and ONS

Growth in London employment was 2.4 per cent in Q4 2017

- Around 4.67 million residents over 16 years old were employed in London in the period September to December 2017.
- The rate of annual employment growth for the capital was 2.4 per cent for the period, 0.5 percentage points down from the third quarter 2017.
- During Q4 2017, the UK had an annual growth rate in employment of 1.0 per cent, 0.1 percentage points higher than the rate in Q3 2017.

Latest release: February 2018
Next release: March 2018

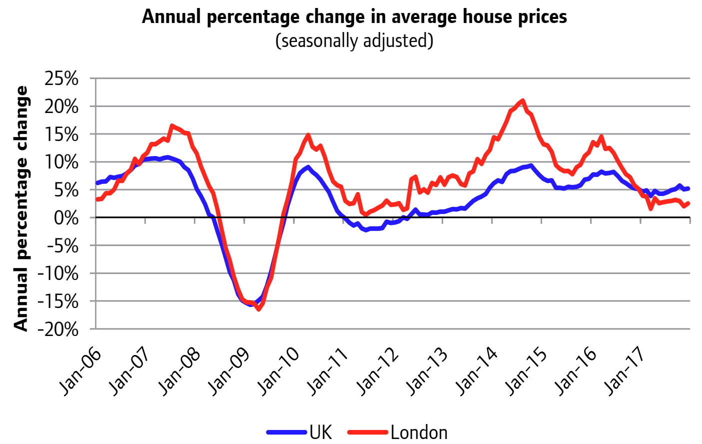


Source: Labour Force Survey - ONS

London house prices increased in December

- In December, the average house price in London was £484,504, more than double the UK average.
- The annual growth rate in house prices in London was 2.5 per cent, 0.5 percentage points higher than November.
- For the UK, house prices grew 5.2 per cent year-on-year in December, 0.1 percentage points higher than November.

Latest release: February 2018
Next release: March 2018



Source: Land Registry and ONS

Business activity growth was modest in London

- 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 modest in January (51.8), representing the lowest levels since July 2016.
- The UK index decreased to 53.5, down from 54.9 in December.

Latest release: February 2018
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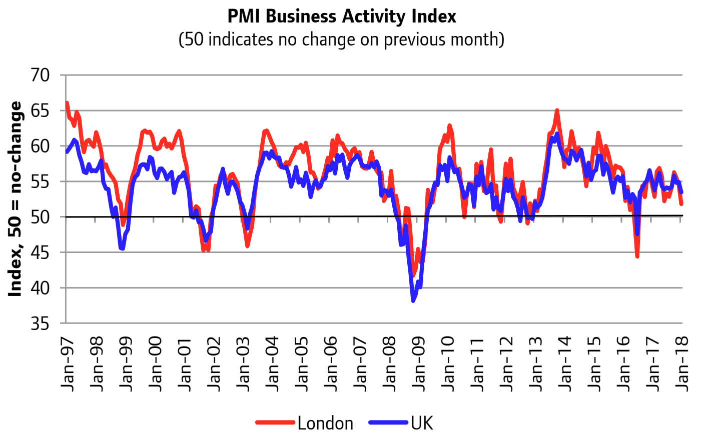

Source: IHS Markit

Moderate increase in new business in London

- The PMI New Business Index was 51.7 in London in January, the lowest recorded index since July 2016.
- UK firms reported an index of 53.8 in January, remaining almost unchanged from 53.7 in December.
- An index reading above 50.0 indicates an increase in new orders from the previous month.

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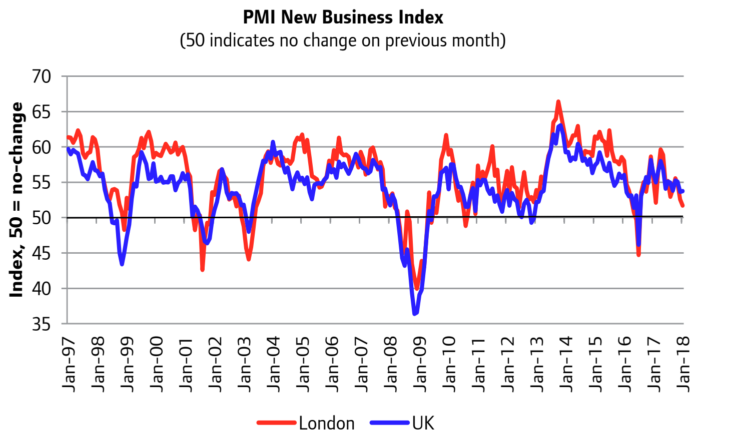
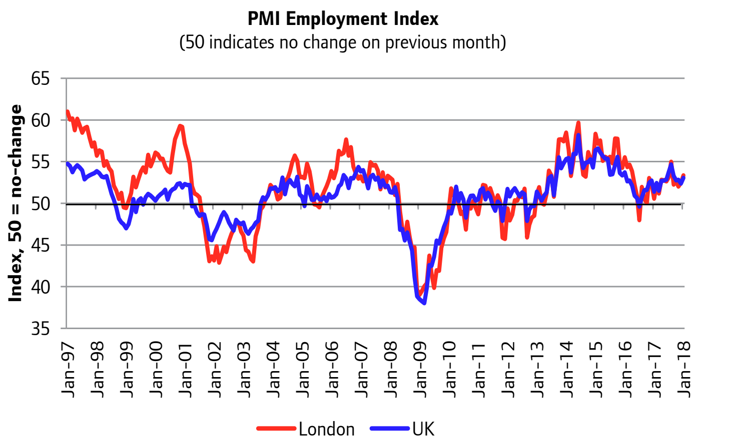


Source: IHS Markit

Stable growth in employment in London

- 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 50 indicates a decrease in employment from the previous month.
- The Employment Index for London was 53.3 in January, representing a rise compared to the recorded index of 52.5 in December.
- Employment levels increased at a similar speed across the UK in January (53.1).

Latest release: February 2018
Next release: March 2018

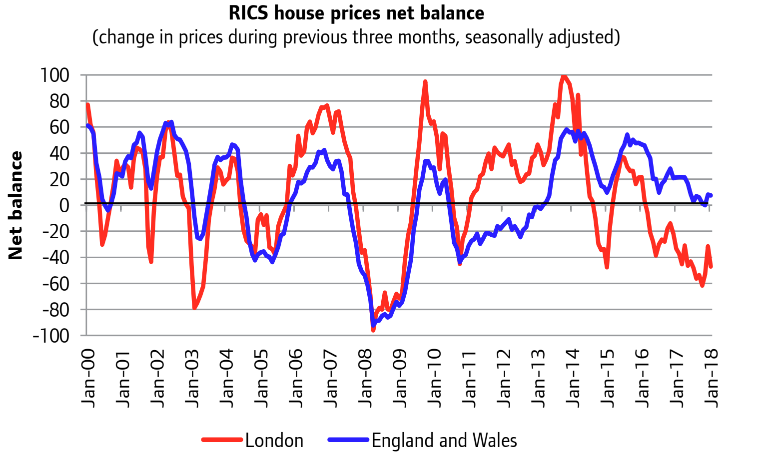


Source: IHS Markit

Most surveyors reported a reduction in London's house prices

- During the period November-January, the net balance of property surveyors reported a contraction in London house prices (-47).
- The RICS house prices net balance index for England and Wales remained stable compared to the last period (+8).
- The net balance index measures the proportion of respondents reporting a rise in prices minus those reporting a decline.

Latest release: February 2018
Next release: March 2018

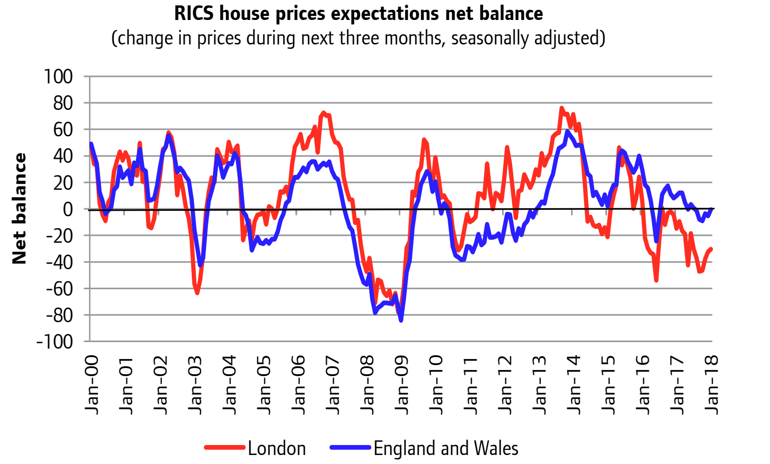


Source: Royal Institution of Chartered Surveyors

Net negative house prices expectations in London persist

- Most surveyors continue to have negative expectations for the next three months for house prices in London. However, the RICS index increased slightly to -30 in January, from -32 in December.
- London remains the region with the most negative expectations for house prices.
- Sentiment in England and Wales was -1 in January.

Latest release: February 2018
Next release: March 2018

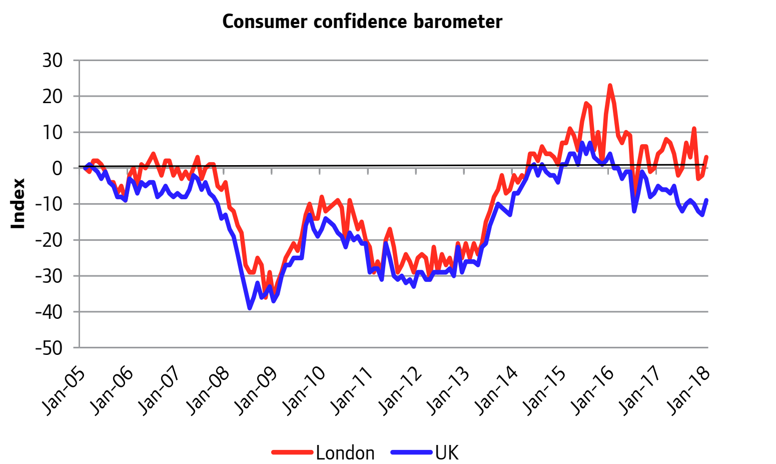


Source: Royal Institution of Chartered Surveyors

Consumer confidence turns positive in London

- 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 consumer confidence index in London was positive (+3) in January after two months showing negative sentiment.
- However, sentiment remained negative for the UK (-9), as it has been since January 2016.

Latest release: January 2018
Next release: February 2018



Source: GfK NOP on behalf of the European Commission

By **Christopher Rocks,**
Economist

In October 2017, the Migration Advisory Committee called for evidence on the impacts of international students in the UK. To support the Mayor's response, GLA Economics has drawn on a range of evidence to examine the role played by overseas students in London, both those from EU and non-EU countries.

This article summarises some of our key findings, looking at the latest trends in international student enrolments, before turning to evidence on the costs and benefits of overseas students. Due to data availability, we focus on the higher education (HE) sector.

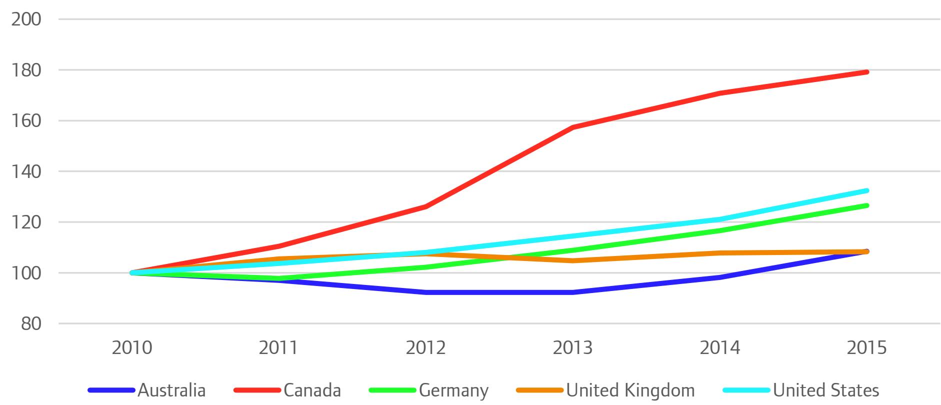
Global demand for higher education has been expanding rapidly

The number of international students engaged in tertiary education programmes worldwide surged in recent decades – rising from 0.8 million to 4.6 million from 1975 to 2015. Advanced English-speaking economies continue to be the largest host countries, with the UK the second most common destination for mobile students (after the United States). But, as they become a more important source of enrolments and (export) income for education providers, there are signs that competition for international students is intensifying.

Several OECD countries are, for example, developing policies aimed at becoming more attractive to overseas students. France and Germany have set targets to increase their market share in terms of internationally mobile students; Canada and Australia are implementing policies aimed at simplifying immigration procedures; and a growing number of institutions in non-English-speaking countries are offering tertiary education taught in English. As Figure 1 shows, the UK's population of international HE students is now increasing at a slower rate than in other large countries – albeit from a higher starting point.

Figure A1: Trends in international HE students enrolled in selected countries, 2010-2015, Index: 2010=100

Source: OECD Statistics



International students make up a significant part of London's HE users

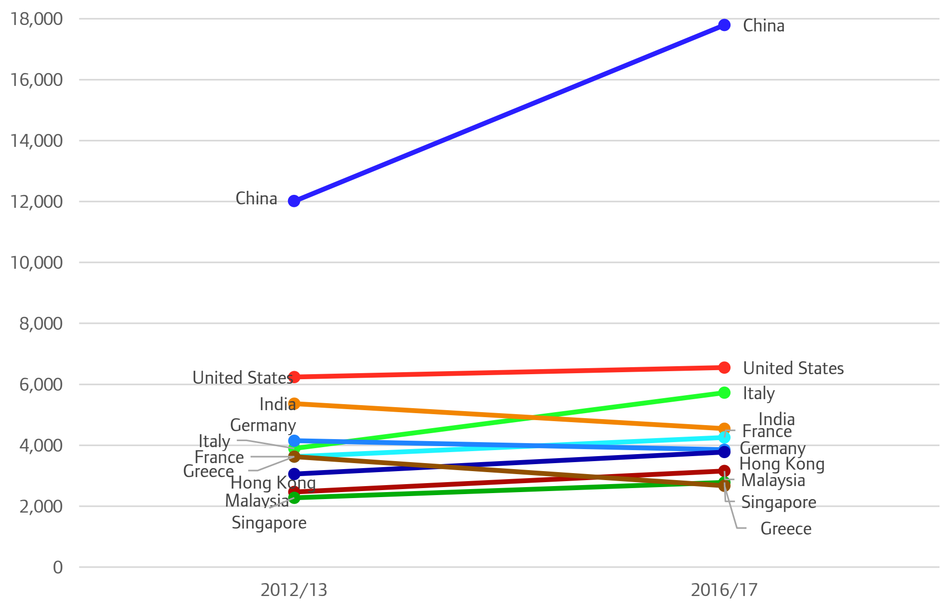
The scale of international students studying in London underlines their importance to the capital's education sector. Data from the Higher Education Statistics Authority (HESA) shows there were 112,205 non-UK domiciled students studying at London HE providers in 2016/17. They accounted for 29 per cent of the total student population, rising to 41 per cent at postgraduate level. Overall, London attracts almost a quarter (24 per cent) of the overseas students studying in the UK, compared to 14 per cent of UK-domiciled students.[1]

These international students have been important in maintaining student numbers at the capital's HE providers over the last five years. Since 2012/13, a 4 per cent fall in the number of UK-domiciled students (-12,800), has been offset by a 3 per cent (+1,200) increase in students domiciled in the rest of the EU and 21 per cent (+12,900) rise in non-EU domiciled students. Going forward, demographic forces could make the role of international students even more important to the UK's HE sector.

With 17,795 students studying in 2016/17, China is by far the leading international student source market for higher education providers in the capital, and the fastest growing. Looking at trends since 2012/13 (Figure A2), Chinese student numbers have grown by around 48 per cent. The next largest increases in international students during this time were from Italy and Hong Kong. Conversely, student numbers from several other countries have declined over this period – including from India, Greece and Germany.

Figure A2: Top 10 Countries of domicile (excluding UK) in London for 2016/17, for HE enrolments in 2012/13 and 2016/17

Source: HESA



And make a considerable economic contribution to the London and UK economy

As well as maintaining enrolments, research carried out by London & Partners, the official promotional company for London, demonstrates the considerable economic impact made by international students to the London and UK economy. According to their analysis of spending patterns, overseas students studying at London HE providers directly contributed £3.448 billion to the UK economy in 2016/17. This was up from £2.990 billion reported for the 2013/14 academic year – an 11 per cent increase in real terms. Based on assumptions about the impact of international students' spending by sector, this translates

1 In addition, term-placements/exchange students – which are not otherwise counted in statistics – are another source of international student numbers in London.

to around £1.803 billion in GVA for 2016/17, up by about 7 per cent since 2013/14 (in real terms).

Of the three channels reviewed to calculate total expenditure, subsistence spending was the most significant in London, making up £1.745 billion of international students' economic contribution. This was followed by the tuition fee income paid to HE providers, at £1.523 billion. Finally, London's student population also promotes tourism activity from family and friends visiting people studying in the capital, estimated to be worth around £180 million in 2016/17.

There are also wider impacts of international students

However, international students also bring a number of indirect or less tangible benefits to London and the UK. They can play an important role in the labour market whilst studying and generate soft power benefits for the UK. According to one survey by London First & PwC, 60 per cent of international students in London (including alumni) said they were more likely to do business with the UK as a result of studying here. Although there is limited quantitative evidence on the institutional and reputational value associated with the presence of international students, the evidence also suggests several ways through which the higher education sector can benefit.

There are, for example, benefits which can accrue to domestic students – who generally value the experience of studying alongside international students, and may benefit from higher funding per student as result of cross-subsidisation by non-EU students (there is, on the other hand, no evidence of international students crowding-out domestic students). Moreover, international students can also stimulate demand for courses where domestic demand alone may be insufficient to sustain them – particularly for STEM subjects, in which a third of OECD mobile students are enrolled, and at postgraduate level. Finally, there are positive effects from overseas students on the UK's research output, which is becoming more reliant on international collaboration.

Although the benefits can be large, they also need to be considered against the potential costs of hosting international students. Yet the evidence available suggests that the demand placed on public services by international students is likely to be far lower than for other groups. Most students report good health, they tend to live in private accommodation, and tend not to use public transport at peak times. While, according to the ONS, there is no evidence of a major issue of non-EU students overstaying their entitlement to stay. As a result, studies which attempt to measure the net economic impact – i.e. the difference between the direct economic benefits and use of public services – suggest highly positive impacts from international students in London.

Conclusion

London is an international city with a long history shaped by globalisation: it already has some of the world's leading universities and a diverse mix of education institutions. International students have made an increasingly important contribution to the capital's HE sector in recent years – supporting student numbers and making a considerable economic and social impact. But, with other OECD countries pursuing policies aimed at becoming more attractive to overseas students, including degrees delivered in English, the future success of London international education sector cannot be taken for granted.

Additional information

Data sources

Tube and bus ridership	Transport for London on 020 7222 5600 or email: enquire@tfl.gov.uk
GVA growth	Experian Economics on 020 7746 8260
Unemployment rates	www.statistics.gov.uk

Glossary

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

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

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

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

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

Tube ridership
Transport for London's measure of the number of passengers using London Underground in a given period. There are 13 periods in a year. In 2017/18 there are twelve 28-day periods and one 29-day period. Period 1 started on 1 April 2017.

Bus ridership
Transport for London's measure of the number of passengers using buses in London in a given period. There are 13 periods in a year. In 2017/18 there are twelve 28-day periods, and one 29-day period. Period 1 started on 1 April 2017.

Acronyms

BCC	British Chamber of Commerce
BRES	Business Register and Employment Survey
CAA	Civil Aviation Authority
CBI	Confederation of British Industry
CLG	Communities and Local Government
GDP	Gross domestic product
GVA	Gross value added
ILO	International Labour Organisation
IMF	International Monetary Fund
LCCI	London Chamber of Commerce and Industry
LET	London's Economy Today
MPC	Monetary Policy Committee
ONS	Office for National Statistics
PMI	Purchasing Managers' Index
PWC	PricewaterhouseCoopers
RICS	Royal Institution of Chartered Surveyors

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

Tel 020 7983 4922
Fax 020 7983 4674
Email glaeconomics@london.gov.uk
Internet www.london.gov.uk

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