

London's Economy Today

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IMF warns trade tensions could cost the global economy \$430bn by 2020

By **Emma Christie**, Economist, and **Yamini Cinamon Nair**, Intern

In its World Economic Outlook Update, the International Monetary Fund (IMF) has warned of the continued escalating tariff war between the US and the rest of the world. They observe that 'the recently announced and anticipated tariff increases by the United States and retaliatory measures by trading partners have increased the likelihood of escalating and sustained trade actions', and say that 'these could derail the recovery and depress medium-term growth prospects, both through their direct impact on resource allocation and productivity and by raising uncertainty and taking a toll on investment'.

While global growth is projected by the IMF to reach 3.9% in 2018 and 2019, GDP growth projections have been revised down for the Eurozone, Japan and the UK for this year. Further, although the advanced economies appear sturdy, the range of triggers - from trade tensions to rising oil prices and political uncertainty - means the global economy is far from stable.

In a continuation of the escalating trade war, on 6th July the US imposed 25% tariffs on \$34bn of Chinese goods - (the tariffs affect industrial parts, vehicles, chemicals, and more). China has since



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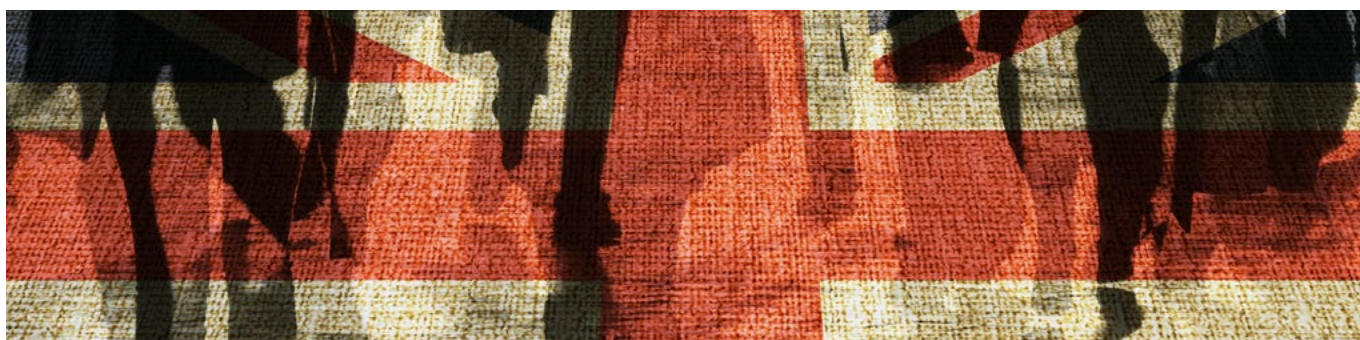
Datastore

The main economic indicators for London are available to download from the [London Datastore](#).

retaliated with the same level of tariffs on US exports to China - (the list of goods affected by the tariffs includes soybeans, pork, fish, orange juice, and whiskey). However, a further 10% of tariffs on \$200bn of Chinese imports is due to be implemented in September, prompting China to issue a formal complaint against the US to the World Trade Organisation (WTO). So far, financial markets remain relatively steady, but it is not known how the markets will react if the September round of tariffs is imposed. Foodstuffs, construction materials, auto parts, electronics and metals have already been affected, and the next round of tariffs promises to target an even wider range of goods, meaning everyday purchases are likely to be affected. China is unable to directly match the \$234bn worth of goods as it does not import that level of US goods, however it could become more aggressive to American business interests, or engage in competitive devaluation of its currency.

The impact on London of deepening trade tensions could be large as the US is the capital's largest export destination. In 2016, 18.6% of London's goods exports went to the US, while in 2015 (the last year for which we have data), 22.6% of London's services exports went to the US. In part reflecting this, the IMF has revised down the UK's growth forecast from 1.6% to 1.4% for 2018. This risk also combines with mounting political and trade tensions associated with other uncertainties such as Brexit.

UK economy boosted by service sector



In better news for the UK economy, GDP increased 0.3% between April and May, (see Figure 1) and was up 1.5% on May 2017. On the three months to May, output was up 0.2%; this was due to a spending boost by British shoppers and better than the flat growth seen in the three months to April which was due to falls in Construction. Rob Kent-Smith, Head of National Accounts, observed that Retailing, Computer programming and Legal services all performed strongly in the three months to May while Housebuilding and Manufacturing both contracted. However, he added that 'services, in particular, grew robustly in May with retailers enjoying a double boost from the warm weather and the royal wedding. Construction also saw a return to growth after a weak couple of months'.

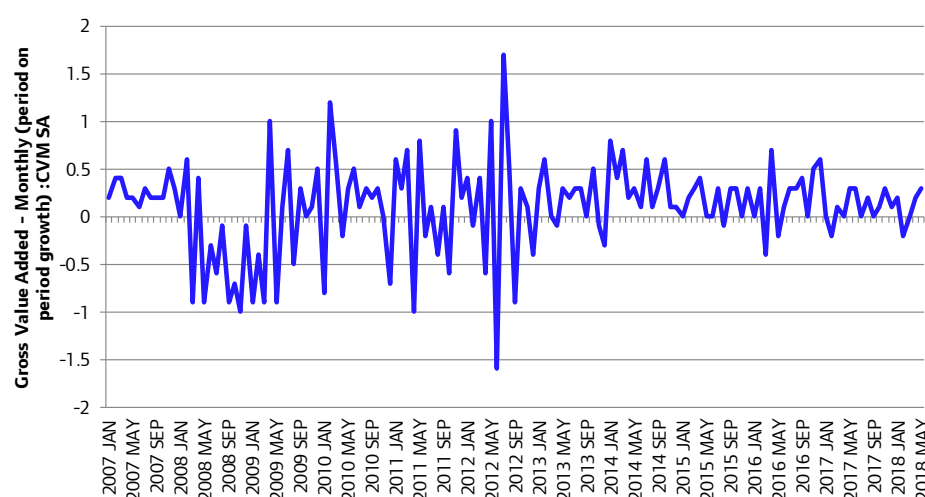


Figure 1: UK GVA growth, monthly (period-on-period), Jan 2007- May 2018

Source: ONS: Monthly GDP

It should be noted that this month marks the first month of ONS improvements to the way in which UK GDP figures are published. As of 10 July 2018, the ONS now publishes rolling monthly and three-monthly estimates of how much the economy is producing, and with significantly higher data content. These figures are to be published at the first half of every month and are intended to give policy makers faster access to how the UK economy is growing and changing. This is a major change from the ONS' previous approach, where estimates were only produced for each calendar quarter, with a preliminary estimate published 25 days after the end of the period. Under the new methodology, preliminary quarter estimates will be published slightly later than previously, but will be more detailed, meaning that more data will be available, faster.

Given this slight improvement in the GDP numbers some commentators continue to believe that the Monetary Policy Committee (MPC) of the Bank of England will raise interest rates in August. However, at the same time, the rate of pay growth for British workers has fallen to a six-month low. Uncertainty over Brexit may also mean the Bank of England delays interest rate changes. Either way, caution must be taken as monthly GDP figures can be volatile and may not represent a long-term trend of GDP growth.

Bank of England Agents find slightly improved economic message



At the end of June, the Bank of England published its Agents' summary of business conditions for Q2 2018. This found that 'there had been a tick up in retail sales growth, helped by stronger sales of seasonal clothing and footwear. However, this was not sufficient to fully make up for sales lost due to the adverse weather in Q1'. However, 'growth in consumer services slowed, particularly in travel and tourism'. Still, 'investment intentions remained modestly positive among manufacturers and in business services'.

Published alongside this were the results from the Banks Decision Maker Panel (DMP). This panel was developed by the Bank of England, in collaboration with academics from Stanford and Nottingham University, to track business expectations and uncertainty. The panel is made up of Chief Financial Officers from small, medium and large firms across a range of industries.

Between February and April 2018, members were asked to assign probabilities to potential impacts of a Brexit deal on their sales. On average higher probabilities were assigned to negative impacts than positive ones. In addition to lowering future sales, Brexit was considered one of the top three sources of uncertainty for 37% of panel members. Data from the DMP survey has provided quantitative evidence on how investment has been already affected by Brexit. In the year after the EU referendum, investment growth is estimated to be lower for Brexit exposed businesses than for businesses that expected no impact from a Brexit deal or a positive one.

UK net migration from EU falls to five-year low



In further Brexit news, net migration from EU countries to the UK in 2017 dropped to its lowest level in four years (see Figure 2). In December 2017, net migration to the UK from the EU was 101,000. While EU migrants continue to add to the UK population, the number of EU citizens entering the country ‘looking for work’ continued to decrease over the last year. This could indicate uncertainties around Brexit, such as the final schedule of rights of EU nationals in the UK that will be secured. Despite this fall in EU migrants, at the same time non-EU net migration is at its highest level since September 2010.

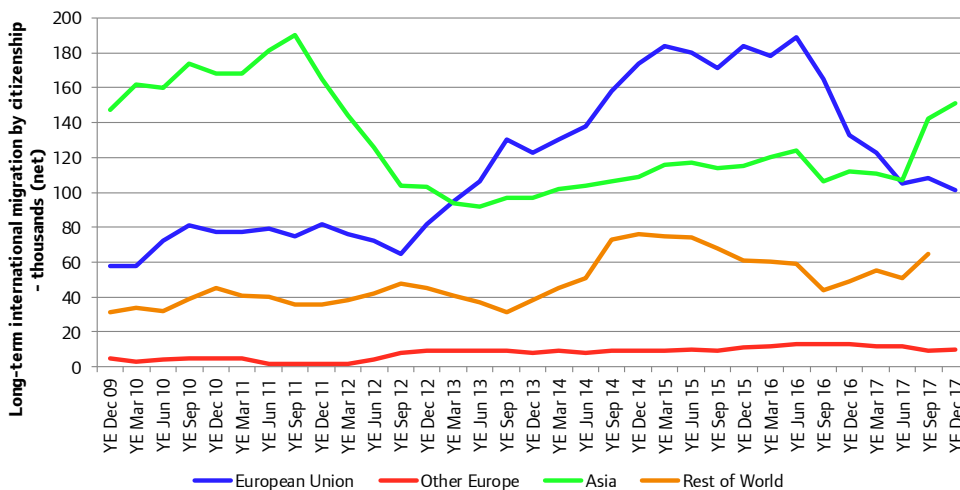
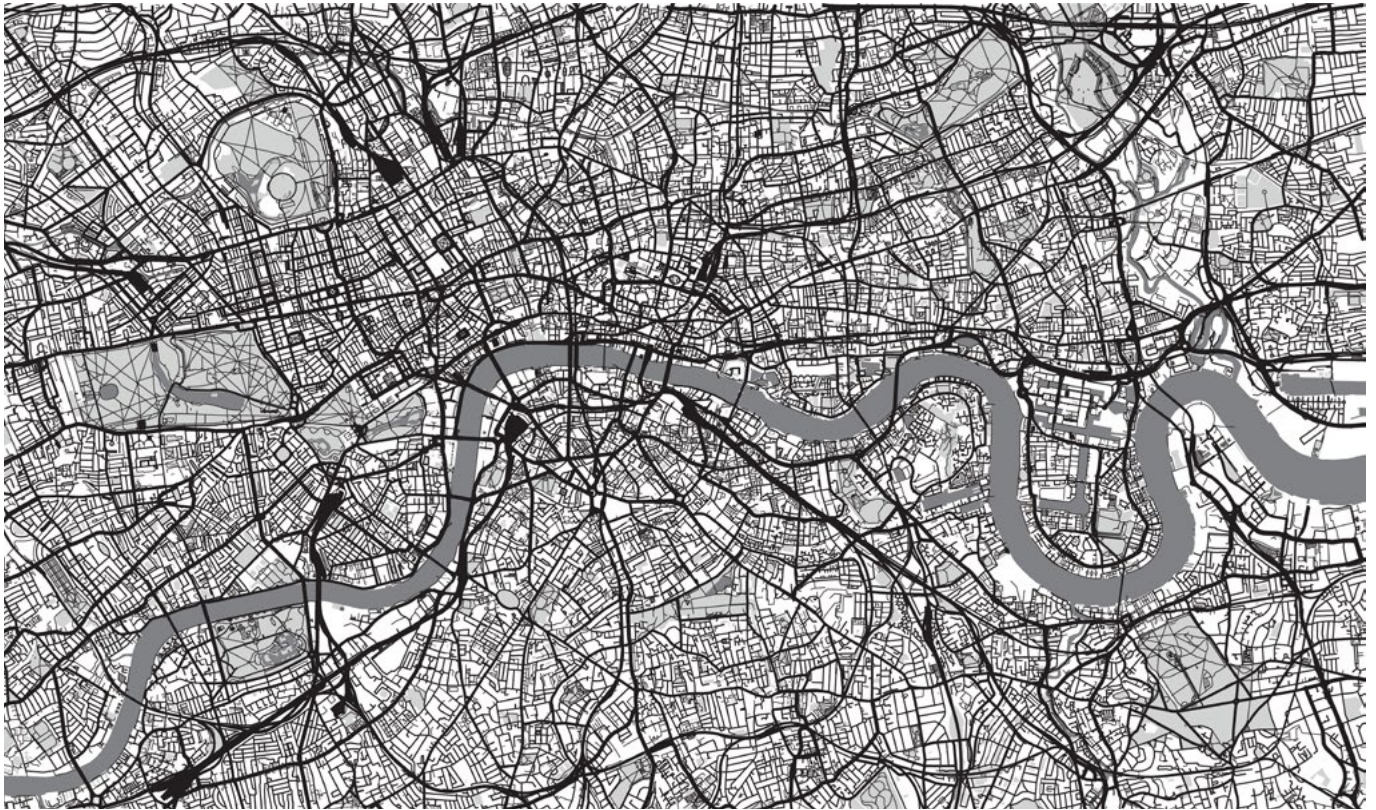


Figure 2: Net long-term international migration to the UK, by citizenship (thousands)

Source: ONS: Provisional long-term migration estimates

It is yet unknown what the future relationship with the UK and EU will be. However, in July the UK Government published a white paper outlining its proposed plans. Notably in the paper the Government said it would seek to improve on the current requirements for equivalence of rules for Financial services between the EU and outside countries for the post Brexit relationship. This is seen as a loosening of the UK/EU Financial services relationship post Brexit. Still, these plans are yet to be agreed with the EU and are likely to see continued evolution over the coming few months to the negotiation deadline date.

A continued mixed picture on London's economy



New employment data for London was published by the ONS in July. This showed that from March to May 2018, London's employment rate fell on the quarter by 0.4 percentage points. Over the same time period, London's unemployment rate increased by 0.3 percentage points. Further, the unemployment rate continued to be lower in the UK (4.2%) than in London's (5.1%). Still, on the year London's employment rate is higher, up 0.7 percentage points, while its unemployment rate is lower, down 0.4 percentage points on the year.

House price data in London also continues to show falls (prices decreased by 0.4% in the year to May 2018), compared to strong growth in the other English regions (see Figure 3). According to the ONS, 'London has shown a general slowdown in its annual growth rate since mid-2016', with May representing the 'fourth consecutive month that London house prices have fallen over the year'. This said, London continues to be the region with the highest average house prices at £479,000, compared to an average of just £244,000 for England as a whole.

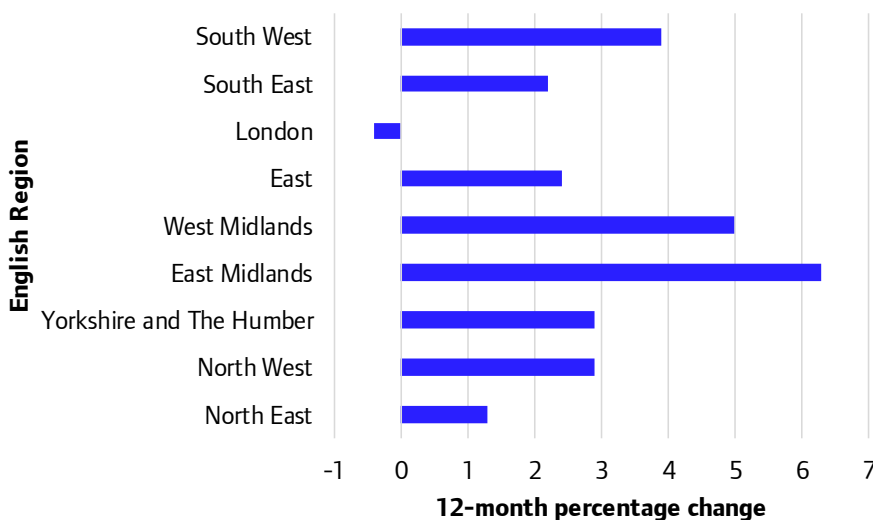


Figure 3: All dwellings annual house price rates of change, year to May 2018, by English region

Source: HM Land Registry and ONS

This fall in house price growth comes amidst calls from the Institute for Public Policy Research (IPPR) for the Bank of England to freeze house prices. The IPPR argues that the Bank should be given new powers to target zero house price inflation (i.e. through mortgage restrictions) in the same way it seeks to maintain general inflation. On the proposals, IPPR research fellow, Grace Blakeley, said that to help spur GDP growth, 'we need to move towards a more sustainable growth model, one built on production and investment, rather than on debt and speculation. To do this we must break the cycle of ever-rising house prices driving property speculation, crowding out investment in the real economy'.

Still, other indicators show continued growth in London with for instance the Morgan McKinley London Employment Monitor showing a '29% increase in job seekers, month-on-month' in Financial services. Hakan Enver, Managing Director, Morgan McKinley Financial Services, observed that 'to have a non-January job-seeker spike like this demonstrates a return of extraordinary confidence in London's financial services jobs market'. The Q2 2018 Capital 500 survey from the London Chamber of Commerce and Industry (LCCI) found that 'during Q2 2018, all Capital 500 business confidence indicators recorded a reverse of last quarter's decline. The Capital 500 balance figure for overall company prospects logged a record level increase on the last quarter (up 10 points) and is no longer in negative territory at 0% – the joint highest recorded level since Q2 2016, the last poll before the EU referendum'. Other measures, however, were less optimistic with 'more businesses continuing to report a decline in domestic demand than an increase during Q2 2018, [with] figures...in negative territory for eight out of the last nine quarters'.

The second London Business 1000 report by London Chamber of Commerce and Industry (LCCI) and London Councils - which looks at more longer-term issues - was also published in July, with a focus on skills. This found that 'the most common roles identified as facing skills challenges are skilled manual/technical roles', although it also found that 'compared to last year's survey, the percentage of London businesses that employ apprentices has increased from 8% to 17%, but there has not been a significant increase for non-levy payers'.

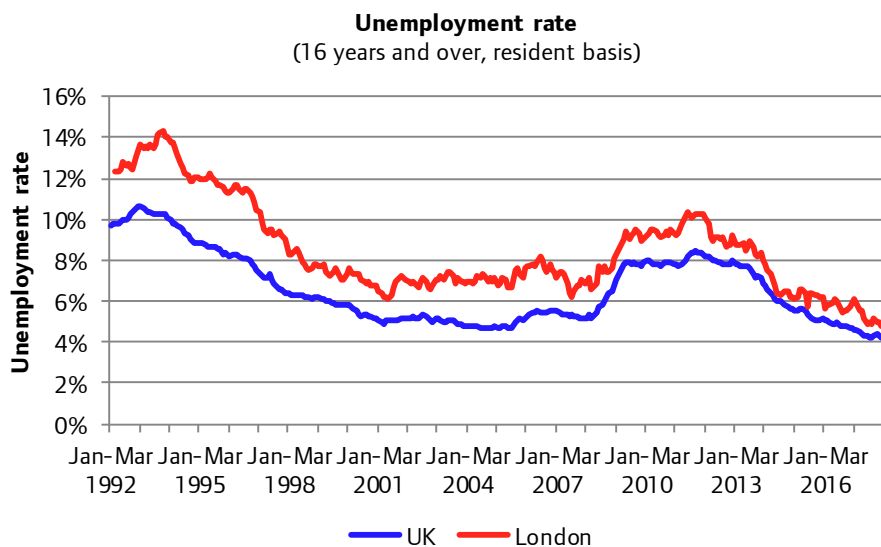
In conclusion, the UK and London's economic growth continues, but as has been the case for the past few years they both face a multitude of growing risks from international and domestic trends.

London's unemployment remains low

- 255,251 residents over 16-year-old were unemployed in London for the three-month period March-May 2018.
- The unemployment rate in London increased to 5.1% in that period from 4.8% in the previous quarter of December 2017-February 2018.
- The UK's unemployment rate remained at 4.2% in the three-month period March-May 2018, the same level it has stood at since the three-month period December 2017-February 2018. This rate represents a joint historic low.

Source: ONS Labour Force Survey

Latest release: July 2018, Next release: August 2018

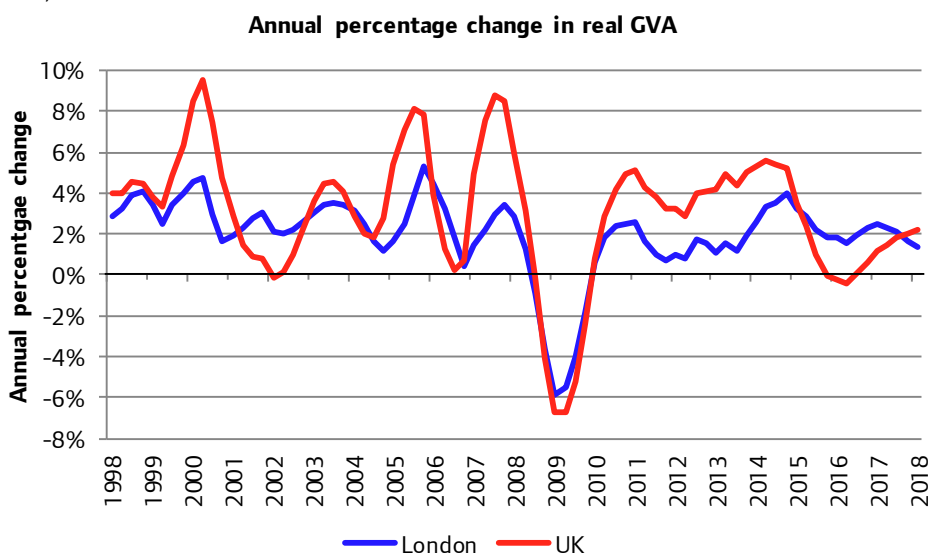


London's annual output growth reached 2.2% in Q1 2018

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

Source: ONS and GLA Economics

Latest release: July 2018, Next release: October 2018

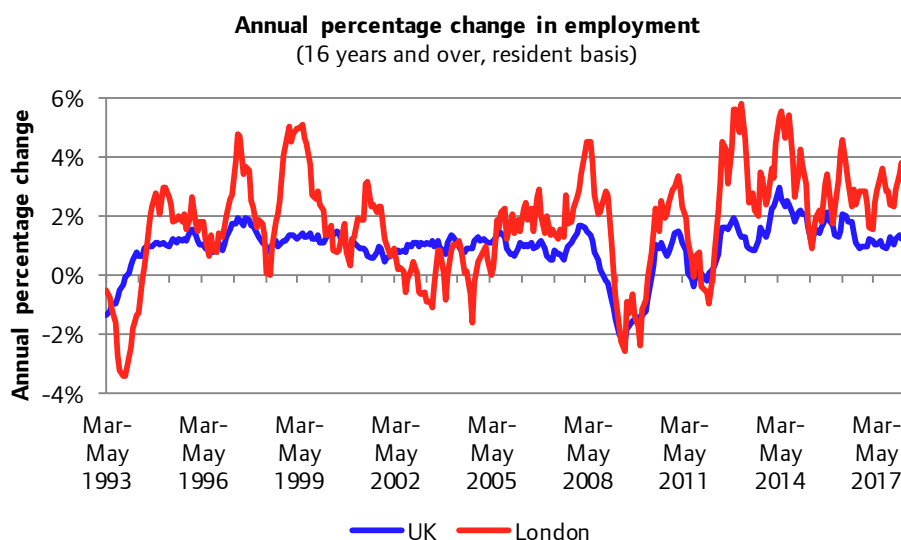


Annual growth in employment in London continues but at a slower pace

- More than 4.72 million residents over 16 years old were employed in London during the three-month period March-May 2018.
- The rate of annual employment growth for the capital was 2.0% for this period, 1.4 percentage points slower than registered for the previous quarter of December 2017-February 2018.
- In the March-May 2018 period, the UK grew annually at a rate of 1.2%, 0.1 percentage points down from the previous quarter.

Source: ONS Labour Force Survey

Latest release: July 2018, Next release: August 2018

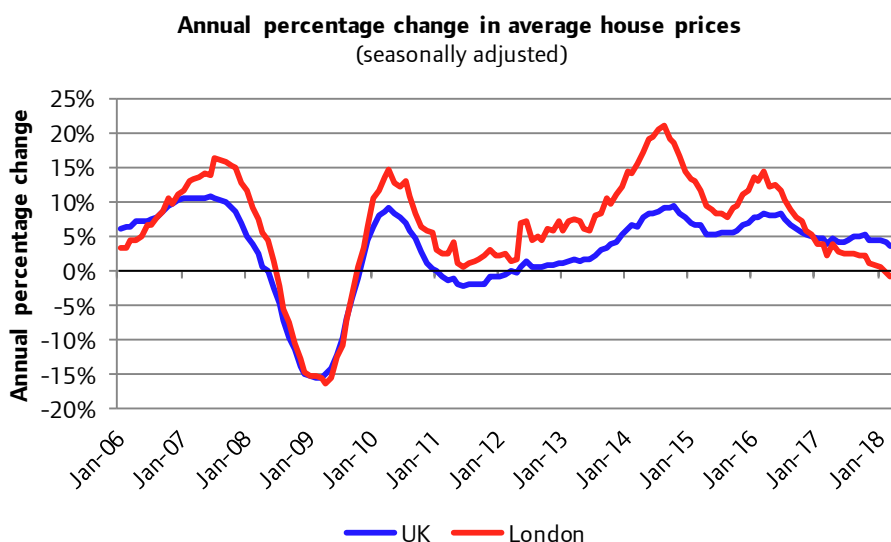


Average house prices in London have decreased for four consecutive months

- In May, the average house price in London was £476,643 while for the UK the average was less than half of London's prices (£224,628).
- The annual growth rate in average house prices in London was -0.4% in May, down from -0.2% in April and the fourth consecutive negative rate this year. London house prices continue the downward trend started in September 2017.
- For the UK, house prices grew 0.6 percentage points slower in May (3.0% year-on-year) compared to April.

Source: Land Registry and ONS

Latest release: July 2018, Next release: August 2018

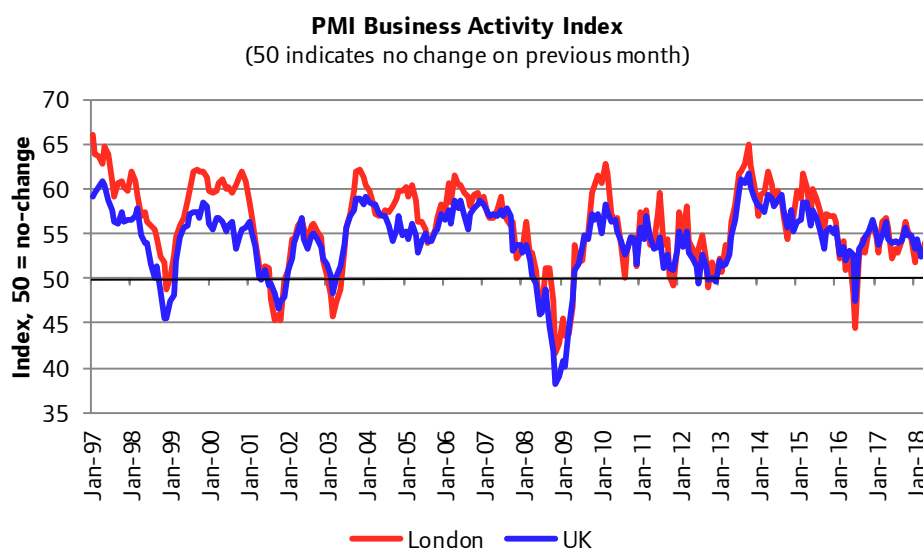


Stronger growth in London business activity in June

- 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 56.2 in May, reaching the highest figure of the year so far.
- The UK index also increased from 54.5 in May to 55.2 in June, the highest level of the year as well.

Source: IHS Markit

Latest release: July 2018, Next release: August 2018

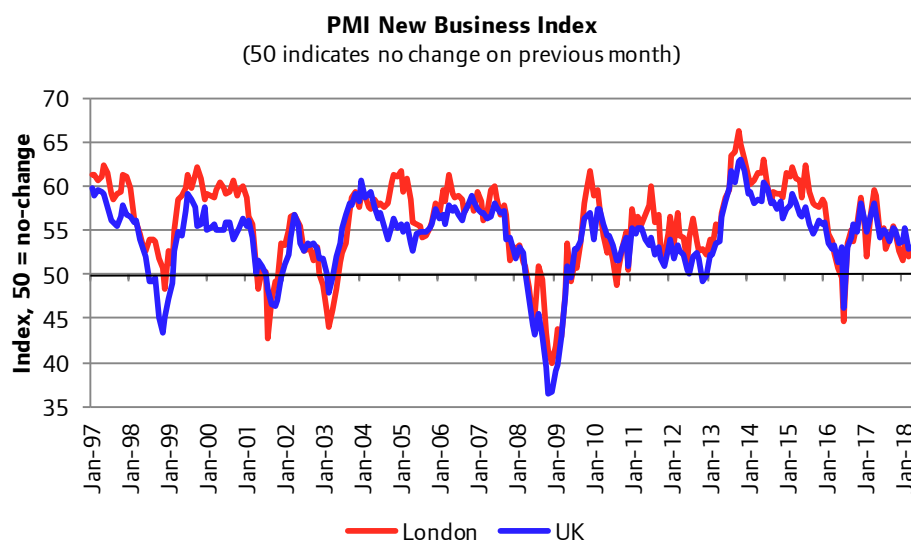


Growth in new business remains solid in London

- The PMI New Business Index was 55.0 in London in June, up from May (52.8).
- Meanwhile, UK firms reported an index of 55.3 in June, also higher compared to the 53.3 seen in May.
- An index reading above 50.0 indicates an increase in new orders from the previous month.

Source: IHS Markit

Latest release: July 2018, Next release: August 2018

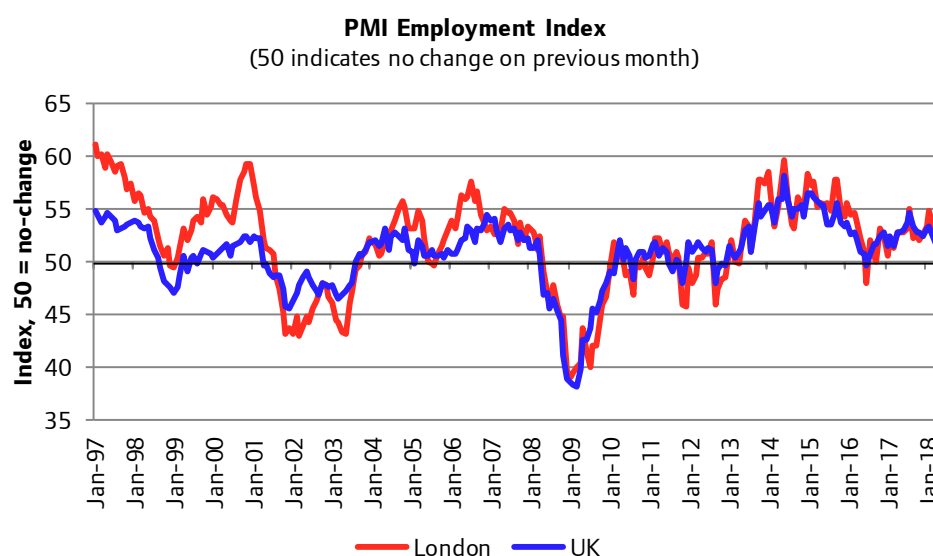


Employment growth in London increases after four months

- The PMI Employment Index shows the monthly change in employment at private sector firms. Readings above 50.0 suggests an increase, whereas a reading below indicates a decrease in employment from the previous month.
- The Employment Index for London was 53.0 in June, higher than in May (51.2), and the first increase in the growth rate since February this year.
- Employment levels also increased across the UK in June (51.9) compared to the previous month (51.6).

Source: IHS Markit

Latest release: July 2018, Next release: August 2018

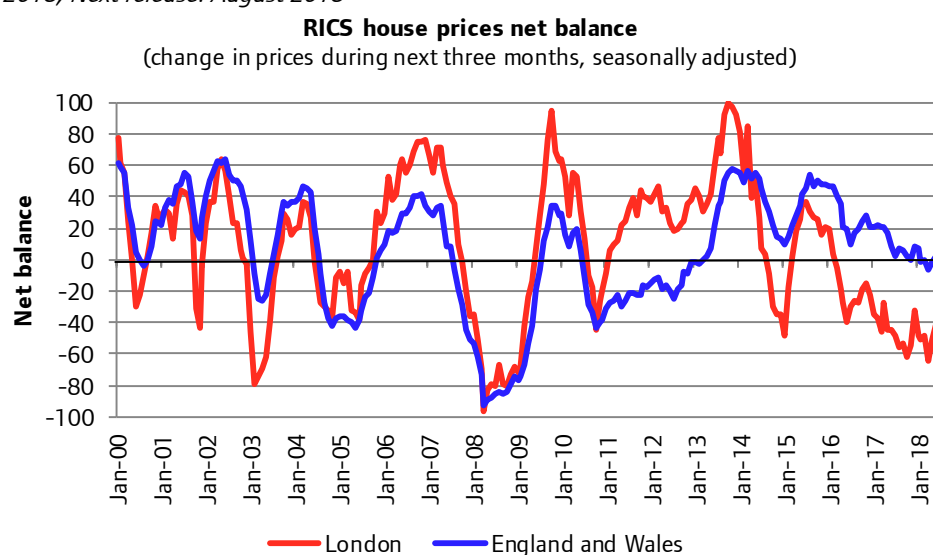


Contraction in London's house prices continues, according to most property surveyors

- During the period April-June 2018, the net balance of property surveyors increased to -41 from -51 in the period March-May 2018. The index has now been negative since the three-month period January-March 2016.
- The RICS house prices net balance index for England and Wales increased from -2 to 2 for the same mentioned period.
- The net balance index measures the proportion of respondents reporting a rise in prices minus those reporting a decline.

Source: Royal Institution of Chartered Surveyors

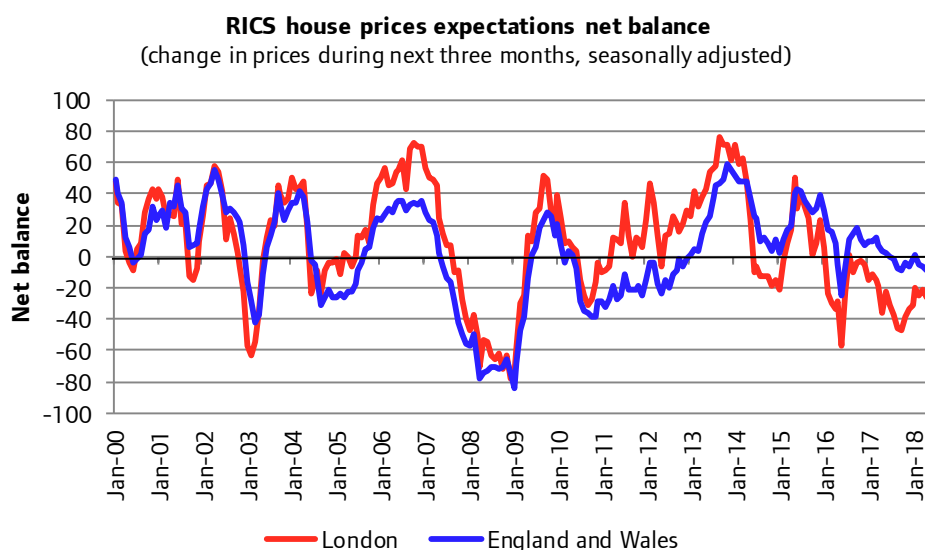
Latest release: July 2018, Next release: August 2018



House prices expectations in London remained negative in June

- Most surveyors continued to have negative expectations for the next three months for house prices in London. The RICS index was -19 in June, up from -26 in May.
- London remains the region with the most negative expectations for house prices.
- Sentiment in England and Wales was also more positive in June (0) compared to May (-9).

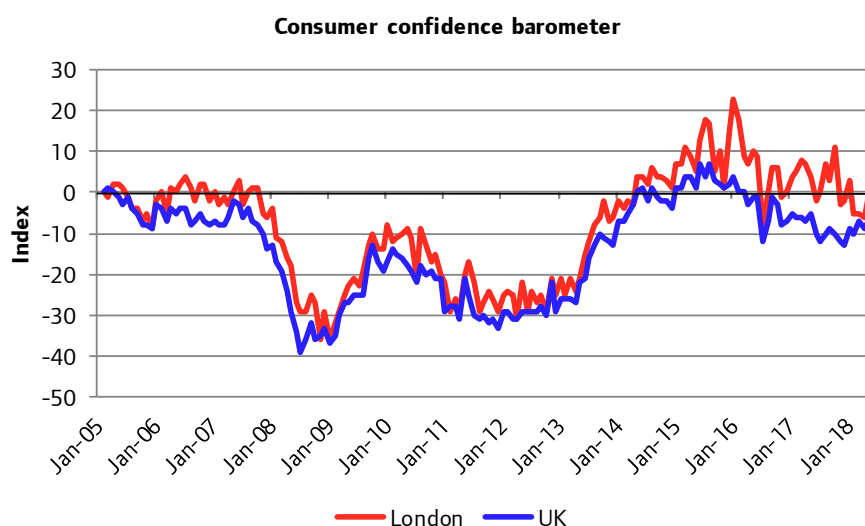
Source: Royal Institution of Chartered Surveyors
 Latest release: July 2018, Next release: August 2018



Consumer confidence in London remained negative in June

- The GfK index of consumer confidence reflects people's views on their financial position and the general economy over the past year and in the next 12 months. A score above zero suggests positive opinions; a score below zero indicates negative sentiment.
- The index in London was -4 in June, down from May (-1). This index has remained negative since February.
- Sentiment was also more negative for the UK (-9) in June compared to May (-7). The UK index has remained negative since April 2016.

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



London's productivity puzzle: drivers and outlook

By **Yamini Cinamon Nair**, Intern and **Christopher Rocks**, Economist



In economic output terms, London is the most productive place in the country, yet – like the rest of the UK – productivity growth has remained far weaker in the aftermath of the 2007/08 financial crisis. This slowdown is a major explanation for stagnant living standards. But what explains this phenomenon (the so-called ‘productivity puzzle’)? And what is the outlook for the years ahead? This article highlights some of the key points emerging from GLA Economics’ ongoing research into London’s productivity performance.

Labour productivity is defined as the quantity of goods and services (economic output) produced per unit of labour input – for example, per hour worked, per filled job or per worker. It is one of the most widely used measures of economic performance and is critical to increasing economic growth in the long run. It also matters because, historically, rising labour productivity has been closely linked to improvements in wages and living standards.

London is one of the most productive places in Europe

At a national level, there is a major shortfall between the level of productivity in the UK and in most other advanced economies. Thus it is [often claimed](#) that workers in Germany and France will by the end of Thursday afternoon have produced what takes the UK worker an entire week. London, however, is one of the most productive places in Europe. Gross Value Added (GVA) per hour worked was 33% above the UK average in 2016 and, according to recent [ONS analysis](#), only Île-de-France (which includes the city of Paris) has a higher level of labour productivity among 52 NUTS1¹ regions in Western Europe².

¹ This stands for Nomenclature of Territorial Units for Statistics. There are 12 NUTS1 regions in the UK with London being one. More detail on NUTS regions in the UK can be found at ONS, [‘Eurostat: An overview of the 3 NUTS and 2 LAU layers in the UK’](#)

² In that analysis the ONS calculated that the Île-de-France labour productivity –measured as GDP per worker – was “54 % above the UK average, followed by London at 39% above the UK average”.

What explains London's productivity advantage? Based on further work [undertaken by the ONS](#), it is not just about having more firms in certain industries, although this plays a part too. Rather it mainly reflects the fact that, within industries, the average London firm displays a higher level of productivity than its counterparts elsewhere. As a result London has a higher share of high-performing businesses and a smaller 'tail' of low productivity firms. This is often linked to economic openness and agglomeration benefits – that is, the proximity of a large number of skilled workers and businesses in the centre of the capital – which facilitate the flow of ideas and knowledge. London also accounts for a relatively high share of UK trade (mainly in [services](#)), with exporters [over-represented](#) among the UK's productivity leaders.

But its productivity growth rate has fallen behind the UK average

Clearly London hasn't had a problem with its overall *level* of productivity, so what is it that's so puzzling? Figure A1 plots the level of GVA per workforce job in London and the UK as a whole between 1998 and 2016 (in 2015 prices). It shows that up until 2007 labour productivity was rising for both geographies – at a rate of 2.8% per year on average in the capital and 1.9% nationally. It's no surprise that productivity took a hit after the 2007/08 financial crisis, given the sharp drop in economic output, what's less clear is the picture thereafter. From 2011–2016 GVA per job flatlined across the UK and actually fell in London (by -0.7% per year on average) as an increase in jobs outpaced growth in output.

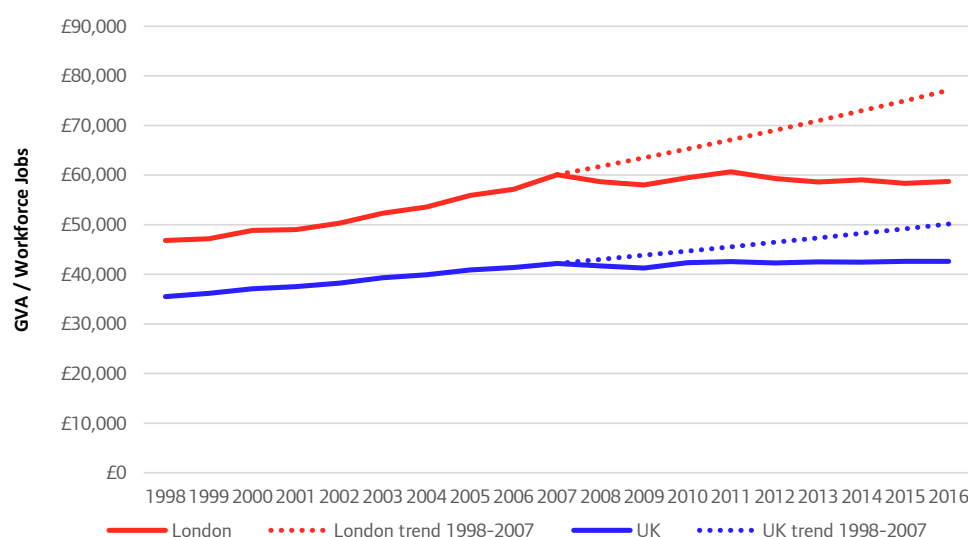


Figure A1: GVA(b) per workforce job for London and UK, 1998-2016 (constant 2015 prices, excluding rental incomes, e.g. housing services)

Source: GLA Economics (2018) GVA(b) per workforce job – excluding rental income – constant 2015 prices

This means that labour productivity in London is now about 24% below where it would have been had its pre-crisis (1998-2007) trend continued, compared to just 15% lower for the UK as a whole. While labour productivity growth in London has departed from trend in previous economic cycles, the recent divergence is wider, with previously high-performing companies seeing the worst falls in [productivity](#) recently. Explaining this prolonged pause has been a significant challenge for academics and policy-makers alike, especially since it has coincided with an unprecedented squeeze in [median earnings](#). The rest of this supplement highlights some of the key points emerging from GLA Economics' ongoing research into this topic.

A mix of factors have been weighing on productivity

One reason often presented for a slowdown in labour productivity is a change in the composition of the economy, specifically a sectoral shift in jobs growth from high productivity to low productivity sectors. Figure A2 shows that between 2011 and 2016 there was a decline in the proportion of jobs accounted for by some high productivity sectors (e.g. Finance and insurance) as well as a rising share in some less productive sectors (e.g. Accommodation and food services). Overall, though, these changes have been relatively small; while other sectors with above average GVA per job – such as Information and communication and Professional services – have also increased their share of jobs in the London economy during this time.

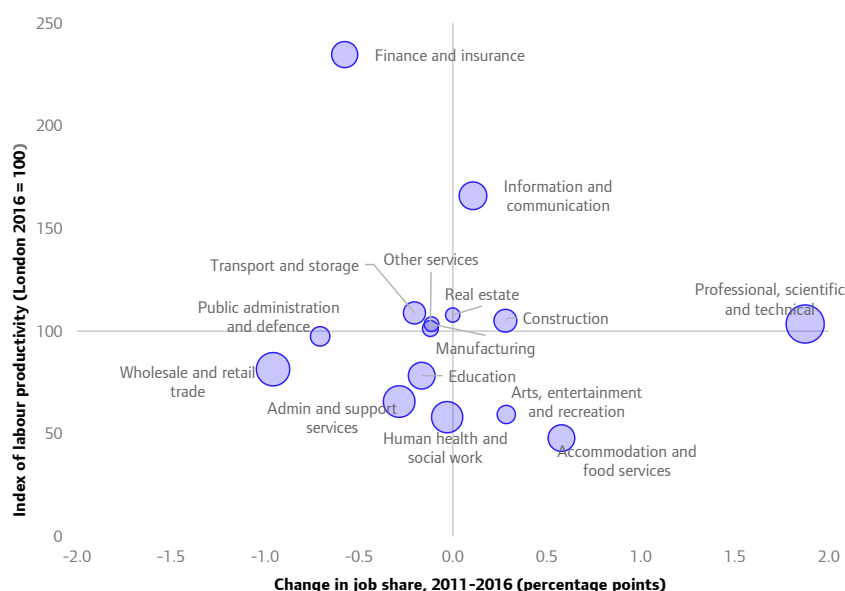


Figure A2: Change in job share in selected sectors and level of productivity

Source: GLA Economics (2018) GVA(b) per workforce job – excluding rental income – constant 2015 prices. Note: does not include Non-manufacturing production or Activities of households. The size of the bubble relates to 2016 job levels

Thus, it is unlikely that a change in the composition of the economy alone can explain the capital's productivity puzzle. Moreover, as set out in Figure A3, there has been a fall in the growth rate of GVA per job in most industries in the last five years, suggesting that wider factors operating 'within' sectors must be at play. That said, the contribution of the Finance and insurance sector is worth highlighting. Not only is this the largest contributor to London's productivity slowdown by sector, it constitutes the largest slowdown in productivity growth of any single industry-region combination in the UK. This can be partly explained by a process of deleveraging following unsustainable growth pre-crisis³. Taken into account, this seems to explain a large part of London's productivity puzzle relative to the rest of the UK (e.g. excluding Finance and insurance, GVA per job growth was flat in London from 2011-2016).

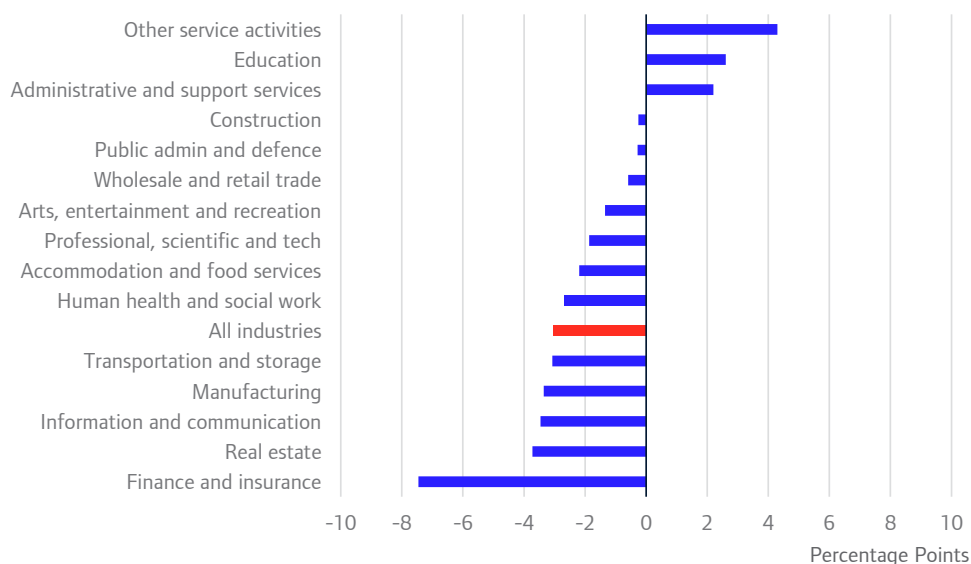


Figure A3: Change in annual average growth rate in GVA(b) per job for selected sectors, London, 2011-2016 vs. 1999-2007 (constant prices, excl. rental income)

Source: GLA Economics (2018) GVA(b) per workforce job per workforce job – excluding rental income – constant 2015 prices. Note: does not include Non-manufacturing production or Activities of households

³ Increased leverage and higher risk tolerance boosted profits, earnings and output in the period leading up to the financial crisis; as banks have sought to deleverage, the financial sector's post-crisis performance has worsened due to relatively weak credit and deposit growth, as well as higher regulatory costs. Part of the apparent slowdown in the sector could also be explained by [mismeasurement](#) (both pre and post crisis).

Yet that doesn't fully explain the productivity slowdown in the rest of the capital's economy. So what other factors are likely to be at play? Two further points are highlighted here⁴. First, jobs growth has been relatively high across most sectors in recent years, with [employment](#) in London reaching record levels. At the same time, there was a widespread fall in business investment during the crisis, and only modest growth since then. So, it appears that firms have been opting for labour recruitment over investments in new plant and machinery. This is [partly attributed](#) to the UK's flexible labour market combined with a ready supply of potential workers, including from the rest of the [European Economic Area](#). It has also been linked to the high degree of economic uncertainty in the UK post-crisis, which may have made labour recruitment more desirable for firms when looking to expand (since it is more easily reversible than investments in fixed capital) as well as contributing to households taking a more precautionary approach in the labour market (e.g. by working more hours).

Outlook for productivity in London

Given the complex mix of factors weighing on London's productivity performance, there continues to be significant uncertainty around the outlook for future productivity growth. Some of the issues highlighted here are likely to ease in the years ahead, particularly as deleveraging in the financial sector runs its course or as [workers become more confident](#) in a tightening labour market. But other influences – including Brexit and automation – are likely to affect productivity in ways that are less obvious. Early signs of rising investment in [labour-saving technologies](#), for example, would need to be weighed against the potential for [lower than expected sales growth](#) and a possible reduction in economic openness in terms of trade or migration. GLA Economics will continue to investigate these issues in the months ahead, with this research being published on our [publications page](#).

⁴ Other explanations not covered include the impact of low interest rates on factor allocation, measurement error, diminishing returns from new innovations, and reductions in the diffusion/dissemination of innovation.

Our latest publications

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

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

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

View all the GLA Economics publications on our [website](#).



Skills strategy for Londoners, Evidence base

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



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

[Download](#) the full publication.



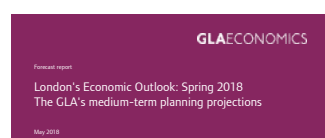
Wider South East experimental labour market projections

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



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

[Download](#) the full publication.



London's Economic Outlook

Our latest London forecast published in May 2018 suggests that:



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

[Download](#) the full publication.

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GLA Economics provides expert advice and analysis on London's economy and the economic issues facing the capital. Data and analysis from GLA Economics provide a sound basis for the policy and investment decisions facing the Mayor of London and the GLA group. The unit was set up in May 2002.