GLAECONOMICS

London's Economy Today

Issue 203 | July 2019

OBR warns that 'no deal' Brexit could lead to a £30 billion decline in public finances

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

The Office for Budget Responsibility (OBR) examined the impact of a 'no deal' Brexit on UK public finances in their latest fiscal risks report (July 2019). This 'no deal' and no transition period scenario was based on recent International Monetary Fund (IMF) work. The OBR assumed that "heightened uncertainty and declining confidence deter investment, while higher trade barriers with the EU weigh on exports. Together, these push the economy into recession, with asset prices and the pound falling sharply. Real GDP falls by 2 per cent by the end of 2020".

Given this scenario the OBR goes on to say "borrowing is around £30 billion a year higher than our March forecast from 2020-21 onwards. Lower receipts – in particular income tax and NICs (due to the recession) and capital taxes (due to weaker asset prices) – explain most of the deterioration". The OBR thus expects income tax and NICs receipts to be lower due to the economic downturn and capital tax receipts to fall due to asset price drops. However, against that they expect debt interest payments to be lower as interest rates fall and for customs receipts to be treated "as UK tax receipts rather than being collected on behalf of the EU" (Figure 1).

Also in this issue

Datastore

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

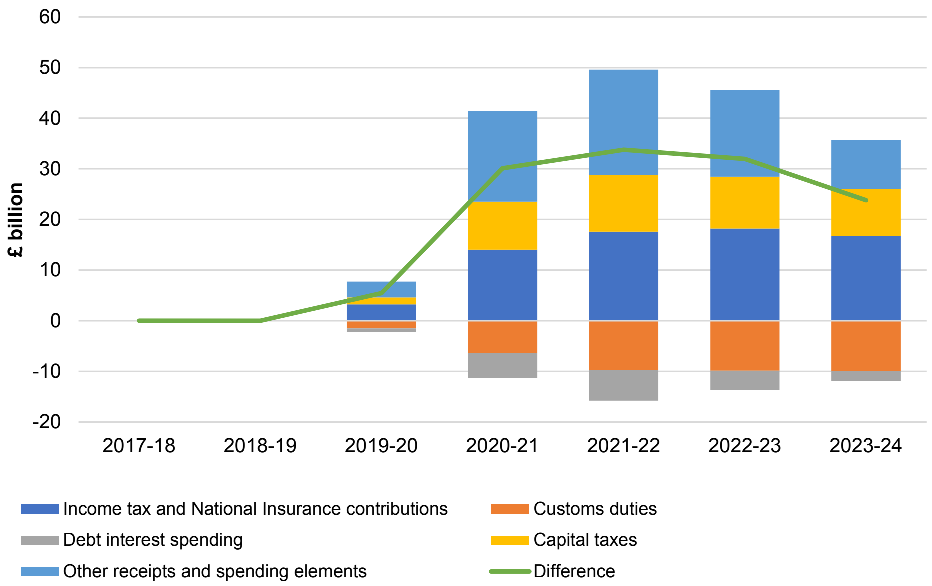


Figure 1: Sources of differences in Public Sector Net Borrowing between the OBR's 'no deal' stress test versus the OBR's March 2019 forecast

Source: ONS & OBR

Note: a positive number indicates higher borrowing

Bank of England says that UK banks can withstand a 'hard Brexit'

The Bank of England also published work looking at the impact of a 'hard Brexit' in their latest Financial Stability report (July 2019) which examines the strength of the UK banking sector. This work also looked at financial resilience in light of escalating international trade tensions. In relation to Brexit the Bank observed that "the perceived likelihood of a no-deal Brexit has increased since the start of the year". Nevertheless "the core of the UK financial system, including banks, dealers and insurance companies, is resilient to, and prepared for, the wide range of risks it could face, including a worst-case disorderly Brexit". The Bank thinks that the banking system remains strong enough to continue lending "through the wide range of UK economic and financial shocks that could be associated with Brexit". However, it did warn that "in a disorderly Brexit, a range of UK asset prices — including the sterling exchange rate, equities, corporate and government debt and bank funding costs — would be expected to adjust sharply, tightening financial conditions for UK households and businesses". While in relation to the possibilities of a slowdown in the global economy due to rising trade conflicts, the Bank noted that "even if a protectionist-driven global slowdown were to spill over to the UK at the same time as a worst-case disorderly Brexit, the [Financial Policy Committee] FPC judges that the core UK banking system would be strong enough to absorb, rather than amplify, the resulting economic shocks".

UK productivity drops again

UK labour productivity fell in the first quarter of the year according to new data published by the Office for National Statistics (ONS) in July. Productivity as measured by output per hour worked fell by 0.2% compared with the same period a year earlier. This was the third consecutive quarter of falling productivity and shows a continuation of the post Great Recession UK productivity puzzle where productivity has grown more slowly than in the pre-recession period (Figure 2).

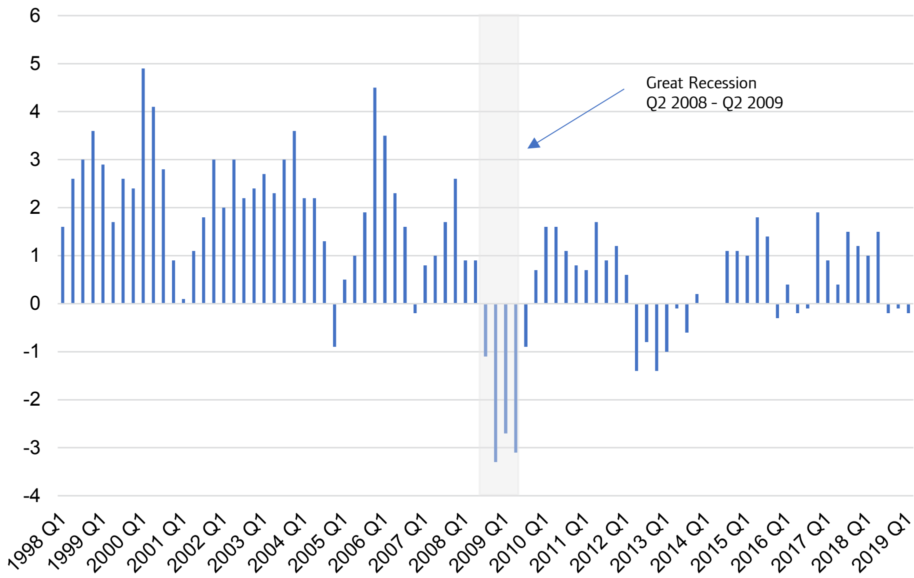


Figure 2: Output per hour, quarter on same quarter a year ago, log growth rates, seasonally adjusted, Q1 (Jan to Mar) 1998 to Q1 (Jan to Mar) 2019, UK

Source: ONS

Despite this poor productivity growth real wage growth has recently picked up with real (inflation adjusted) regular pay estimated to have increased by 1.7% in the year to May according to ONS data. This was in part due to the continuing tight UK labour market and new living wage and minimum wage rates. Deputy head of labour market statistics at the ONS, Matt Hughes, observed that "regular pay is growing at its fastest for nearly 11 years in cash terms, and its quickest for over three years after taking account of inflation". With him adding that "the labour market continues to be strong, with the employment rate still at a near-record high and unemployment down again".

Chinese growth slows on the back of the trade war

Internationally, the fallout from the ongoing trade dispute between the US and China continues to be felt with the Chinese economy growing by the slowest rate since 1990. New data for the three months to June showed that China's GDP grew by an annualised 6.2%, in line with forecasts, but down from the 6.4% annualised growth seen in the first three months of the year. It is believed that most of the slowdown was caused by a weakening in exports which fell by 1.3% on the year in dollar terms in June.

Slow growth is also being seen in other export dependent economies not directly involved in the trade war. Thus, Singapore saw its economy decline by an annualised 3.4% compared with the previous quarter in Q2 2019. This compares to an annualised growth rate of 3.8% seen in Q1 2019. Still, the Asian Development Bank in their latest Asian Development Outlook Supplement forecast that "growth in Developing Asia is projected to expand by 5.7% in 2019 despite the trade conflict between the People's Republic of China and the United States".

Global economic conditions remain subdued with IMF growth forecasts revised down recently. The IMF now expects world growth to stand at 3.2% for this year before picking up to 3.5% next year. Risks to this forecast are mainly to the downside although further trade and technology tensions and certain financial vulnerabilities in some areas might still have a negative effect on global growth in the short term. In particular, Europe also remains finely balanced with the chief economist of the OECD, Laurence Boone, saying that Europe is not well enough prepared for an economic shock. Ms Boone thus observed that "national governments which have fiscal space and a crying need for public investment are not doing it enough, that's for sure". With her also warning that the prospects of an economic shock were real especially if the trade war begins to be directed against Europe.

London continues to see a mixed economic picture

The Q2 2019 Capital 500: London Quarterly Economic Survey from the London Chamber of Commerce and Industry (LCCI) was published in July. This survey was more upbeat than recent ones. David Frost, Chief Executive of the LCCI, observed that the results "suggest there has been a significant shift in the mood in the capital and that the resilient London economy is bouncing back. Domestic and export demand has jumped back up. Firms' cashflow has also improved. All business confidence and economic outlook indicators increased on Q1, suggesting that optimism among London businesses is growing". Although he did further note that "one downside is that investment is still falling, in line with the wider economy. The uncertainty around Brexit is probably the biggest reason. That will not end soon. A Brexit deal of some kind remains everyone's preference, but since it is not in the Government's power to take no deal off the table, it is important that planning and preparation for that scenario continue, so that business can have confidence that, whatever happens on 31 October, they and the country are ready for it".

London's labour market also remains relatively stable. London's 16-64 employment rate was 75.0% in the three months to May 2019, up 0.1 percentage points on the quarter and 0.4 percentage points on the year. While its unemployment rate (the number of unemployed people as a percentage of the labour force) stood at 4.3%, marking a fall of 0.8 percentage points on the previous year.

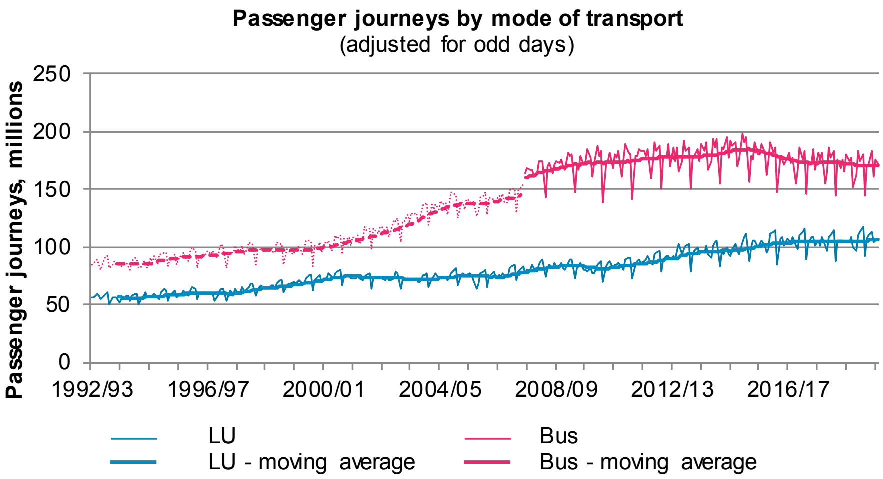
Against this the London housing market continues to be weak with the latest data from the ONS showing that prices fell 4.3% on the year on average in the capital in May 2019, the deepest fall since August 2009. The capital therefore remains in something of a holding pattern, which it has been in for much of the year, with most indicators showing subdued but continuing growth against a background of economic uncertainty.

Economic indicators

TfL passenger journeys remained broadly constant in the last period

- A total of 279.5 million passenger journeys were registered between 26 May and 22 June 2019; 2.5 million less than the previous period. 107.7 million of these journeys were Underground journeys and 171.9 million were bus journeys.
- The 12-month-moving average in the total number of passenger journeys increased slightly from 276.6 million to 276.7 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).

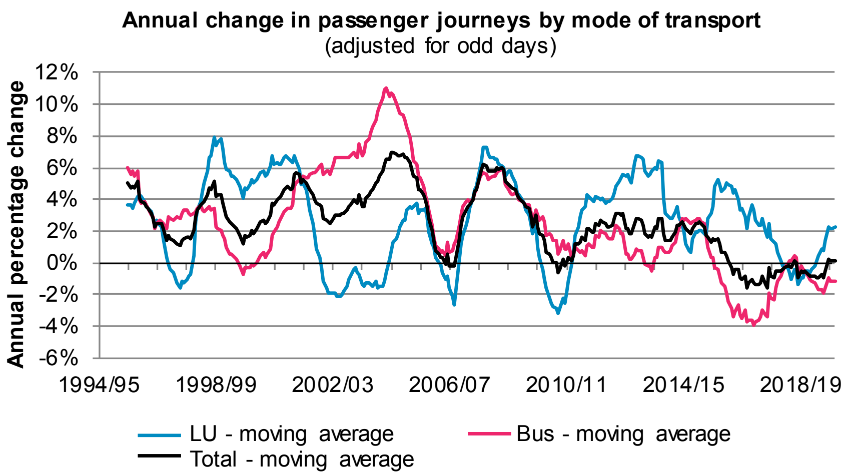
Source: Transport for London
Latest release: July 2019, Next release: August 2019



Annual growth rate in total number of passenger journeys continues to be positive

- The moving average annual growth rate in the total number of passenger journeys remained at 0.1% between 26 May and 22 June 2019, the same level as in the previous two periods. This rate has remained above 0 for four consecutive months after 15 periods of negative growth.
- The moving average annual growth rate of Underground journeys remained unchanged at 2.2%.
- The moving average rate of Bus passenger journeys was also unaltered at -1.2%.

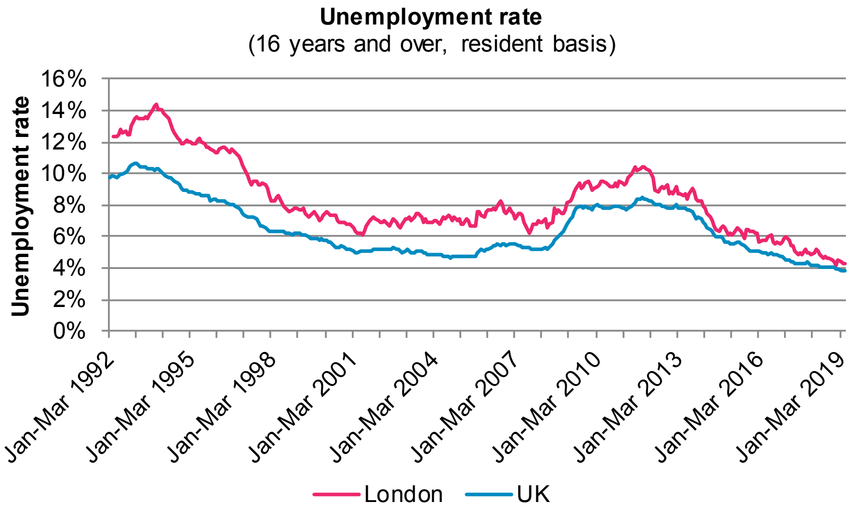
Source: Transport for London
Latest release: July 2019, Next release: August 2019



London's unemployment rate remains low

- 208,763 residents over 16-year were unemployed in London in the three-month period March-May 2019; 9,209 persons less than the three-month period December 2018-February 2019.
- The unemployment rate in London went down from 4.5% during the period December 2018-February 2019 to 4.3% in March-May 2019. This rate represents one of the lowest levels of the series since it began in 1992.
- The UK's unemployment rate stayed at the historic low of 3.8% during the period March-May 2019, 0.1 percentage points lower than the period December 2018-February 2019.

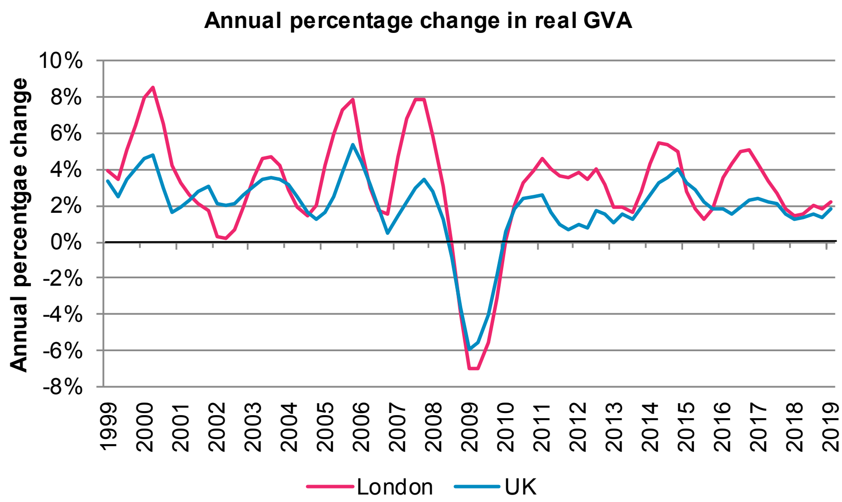
Source: ONS Labour Force Survey
Latest release: July 2019, Next release: August 2019



London's economy grew by 2.2% in real annual terms in the first quarter of the year

- London's annual real GVA growth rose from 1.9% in Q4 2018 to 2.2% in Q1 2019. This is somewhat below the historic average rate of growth in the capital.
- In the UK, annual output growth was 1.8% in Q1 2019, 0.4 percentage points higher than the previous quarter.
- 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 calculations
Latest release: July 2019, Next release: October 2019

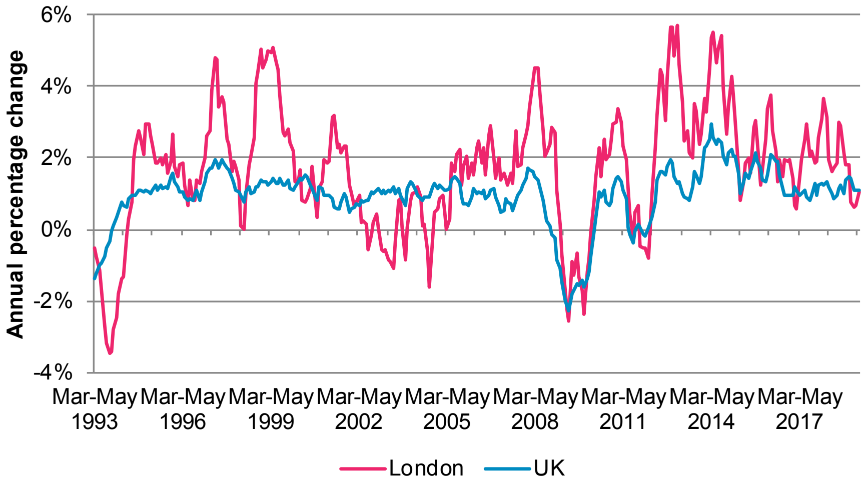


Employment continues to grow in London

- Over 4.68 million residents over 16 years old were employed in London in the three-month period March-May 2019.
- The rate of annual employment growth for the capital was 1.1% for the mentioned period, 0.3 percentage points higher when compared to the three-month period December 2018-February 2019.
- In contrast, the annual growth in UK employment slowed to 1.1% in March-May 2019 from 1.4% in the period December 2018-February 2019.

Source: ONS Labour Force Survey
Latest release: July 2019, Next release: August 2019

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

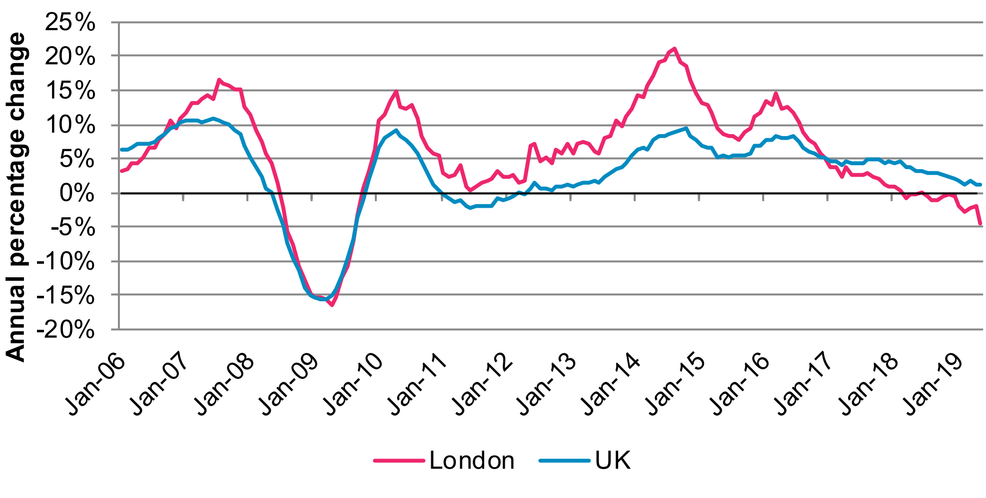


The fall in London house prices accelerates

- In May, the average house price in London was £456,810, while for the UK, the average was £228,148.
- The annual growth rate in house prices in London was -4.3% in May, 2.4 percentage points lower than in April and represented the deepest annual contraction since August 2009. London prices have been falling in year-on-year terms for fifteen consecutive months, registering a cumulative fall of 4.8% over this period.
- For the UK, the annual growth rate in house prices was 1.2%, the same as the previous month.

Source: Land Registry and ONS
Latest release: July 2019, Next release: August 2019

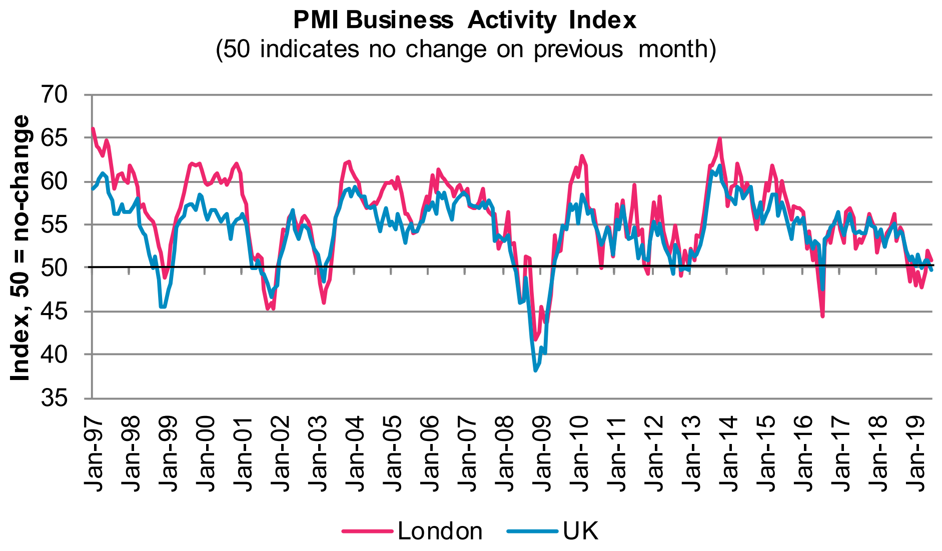
Annual percentage change in average house prices
(seasonally adjusted)



Business activity in London was weak 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 with the majority of firms reporting increased activity, while readings below indicate a decrease.
- Business activity at London private firms was slightly positive in June (50.8) and lower than in May (51.9).
- The UK index decreased in June to 49.7 from 50.9 in May.

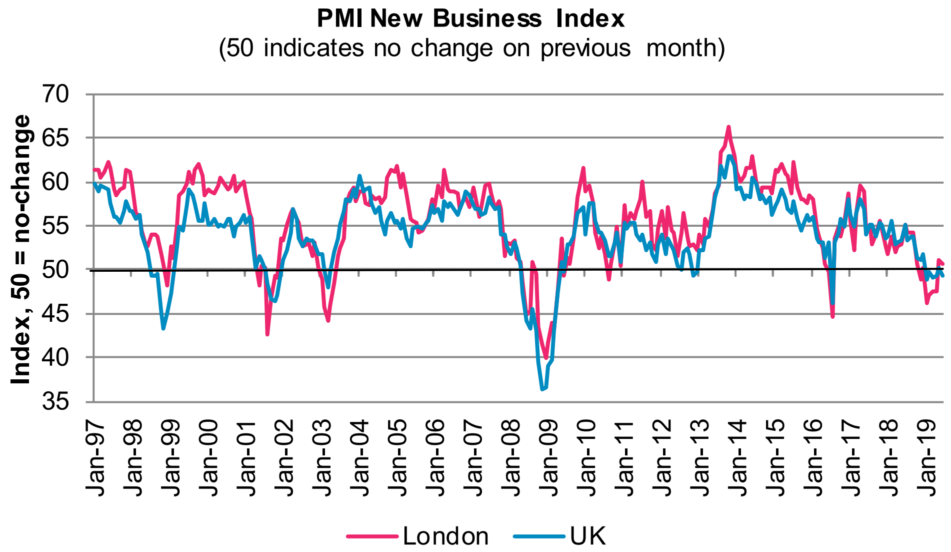
Source: IHS Markit
Latest release: July 2019, Next release: August 2019



New business Index in London was slightly positive in June

- The PMI New Business Index was 50.5 in London in June, down from 51.2 in May.
- UK firms reported an index of 49.3 in June compared to 50.3 in May.
- An index reading above 50.0 indicates an increase in new orders from the previous month for most firms surveyed.

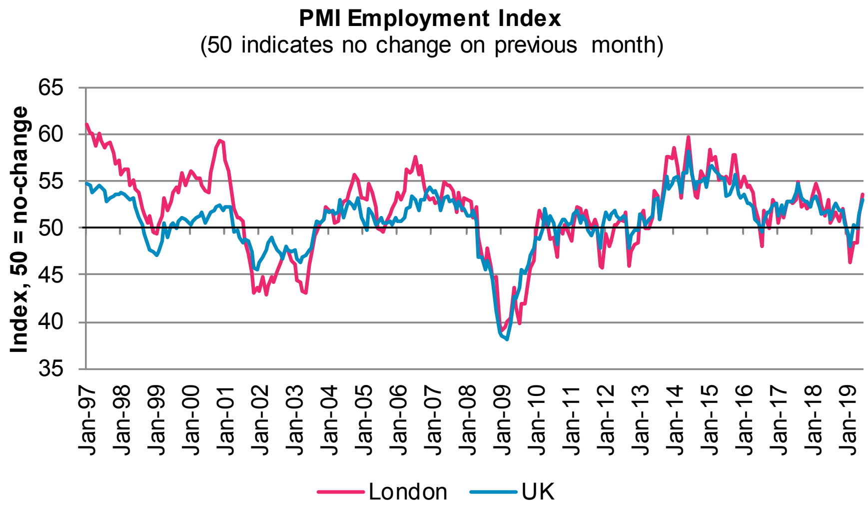
Source: IHS Markit
Latest release: July 2019, Next release: August 2019



Employment grew in London in June according to private firms

- The PMI Employment Index shows the monthly change in employment at private sector firms. Readings above 50.0 indicates over half of surveyed firms have increased employment, whereas a reading below 50.0 indicates a decrease in employment on average across firms from the previous month.
- The Employment Index for London has increased in June to 53.6, when compared to May (51.2). The June value is the highest level since February 2018.
- Employment Index has also increased across the UK in June (53.0) compared to May (51.4).

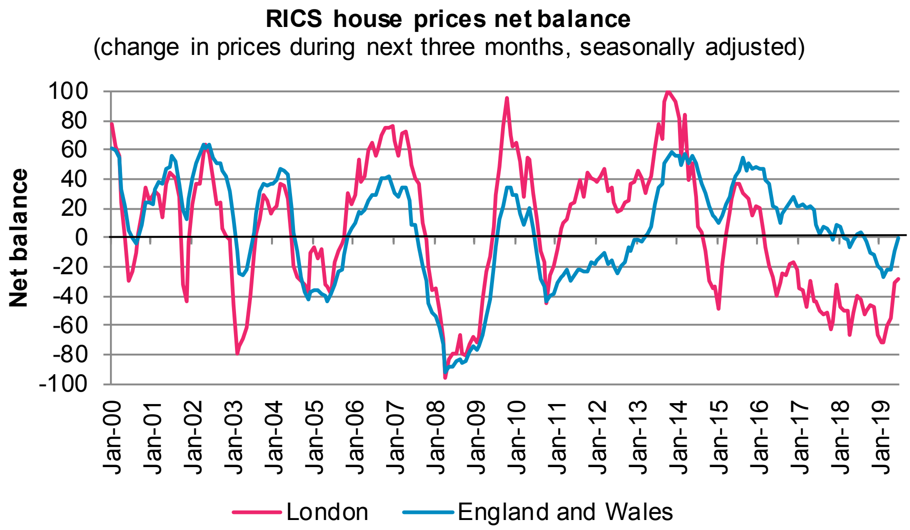
Source: IHS Markit
Latest release: July 2019, Next release: August 2019



Net balance in London's house prices continues to be negative but has improved according to property surveyors

- Most surveyors reported a further fall in London house prices in the three months to June (-28). This index has remained negative since February 2016 but the slow improvement which started in February continues.
- The RICS house prices net balance index for England and Wales also increased from -9 in May to -1 in June.
- The net balance index measures the proportion of respondents reporting a rise in prices minus those reporting a decline.

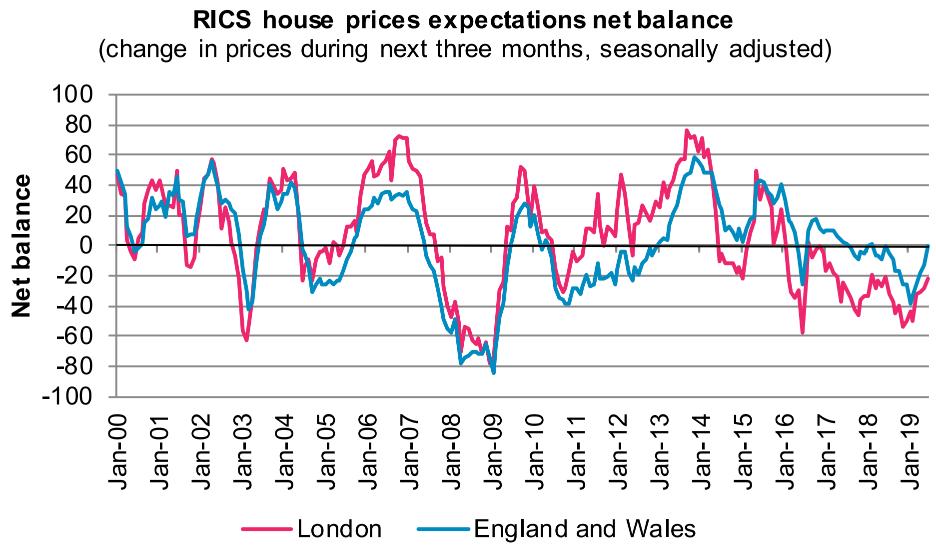
Source: Royal Institution of Chartered Surveyors
Latest release: July 2019, Next release: August 2019



House prices expectations in London stay negative

- Most surveyors continued to have negative expectations for the next three months for house prices in London. The RICS index was -22 in June, higher than in May (-28).
- London remains as the region with the most negative expectations for house prices.
- Sentiment in England and Wales was also less negative in June (-1) compared to May (-13).

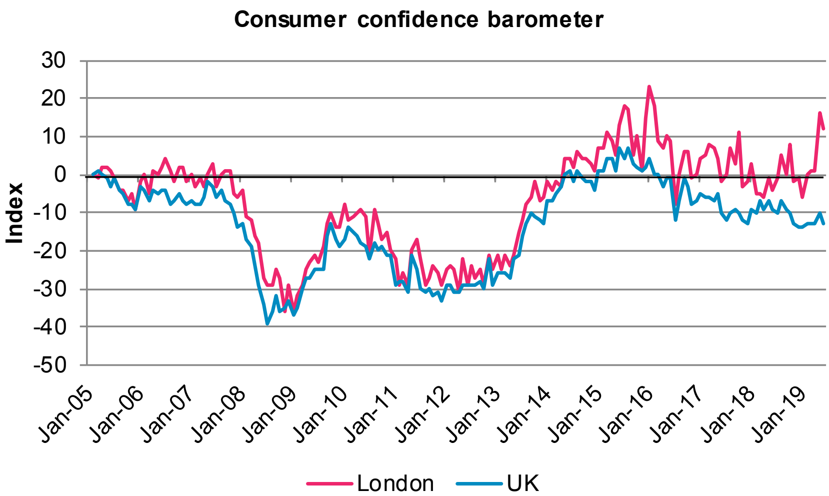
Source: Royal Institution of Chartered Surveyors
Latest release: July 2019, Next release: August 2019



Consumer confidence in London remains positive

- 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 decreased from 16 in May to 12 in June but in historic terms this represents one of the highest levels in more than three years.
- In contrast, sentiment stayed negative (-13) for the UK in June. The index has been negative since April 2016.

Source: GfK NOP on behalf of the European Commission
Latest release: June 2019, Next release: July 2019



Understanding the impact of welfare reform on Londoners

By **Spencer Thompson**, Principal Social Policy Analyst

This month, City Intelligence published the first cumulative impact assessment (CIA) of welfare and tax reform in London[1].

The UK tax-benefit system has undergone wide-reaching changes since 2010, including the gradual rollout of Universal Credit, above-inflation increases in the tax-free personal tax allowance and the introduction of the National Living Wage, alongside a host of other changes.

The CIA compares what we expect the net income of London households to be in 2021/22 with what they would have been had none of the policy changes since April 2010 taken place. This allows us to tell which households have benefitted and by how much, and which have lost out.

Overall, the picture is clear, London households located in the bottom half of the UK income distribution will lose on average, whereas those in the top half will gain. While low-income households in London are expected to receive a boost to income from tax cuts, the introduction of the National Living Wage and Universal Credit, these are outweighed by the reduction in income they will experience from changes to the wider benefit system, especially the working-age benefit freeze. Conversely, better-off households are affected less by the cuts to benefits but have higher taxable incomes and so stand to gain more from a more generous personal tax system.

Figure A1 shows the impact of these changes in cash terms for different types of reform, as well as the total net loss from all reforms together, illustrated by the black dots.

1 See Cumulative Impact Assessment of Welfare Reform in London.

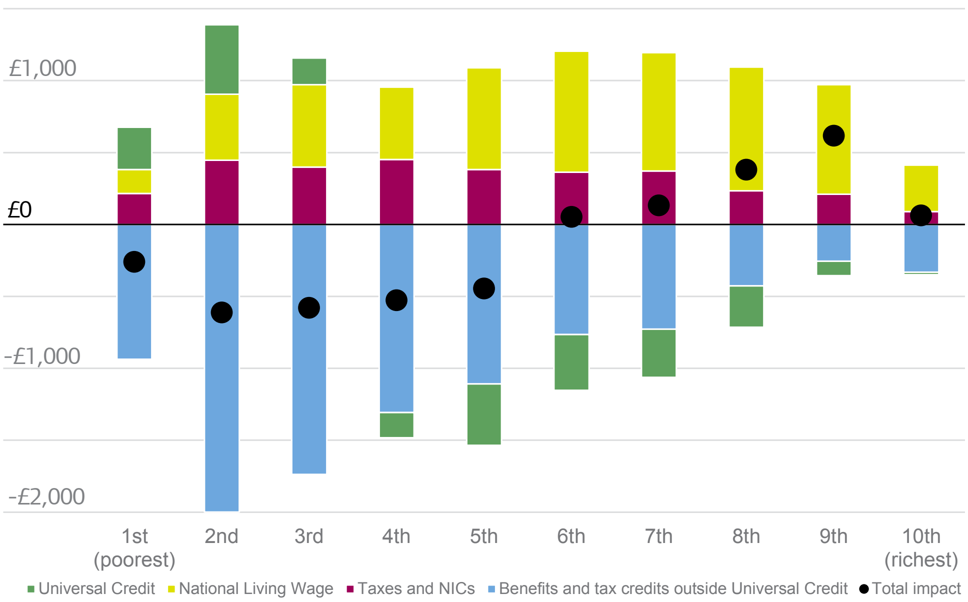


Figure A1: Cash impact of tax and welfare changes and the introduction of the National Living Wage by household net income decile and type of reform, 2021-22: London households

Source: GLA (2019) Cumulative Impact Assessment of Welfare Reform in London

The CIA also allows us to analyse the impact of changes to the tax-benefit system by other characteristics of households. For example, households with children will lose the most of all household types – particularly those households headed by lone parents. This is a result of real-terms cuts to benefits received by parents such as child tax credits and child benefit. On average, lone parent households will receive £2,400 a year less by 2021-22.

Disabled households will lose out substantially. Households where someone is disabled will receive £1,910 a year less on average. Again, this is due to a combination of cuts to benefits that are directly targeted at disabled households, cuts to non-disability benefits, and the fact that disabled households are more likely to be lower on the income distribution.

People from London's black ethnic groups lose more than Asian or white groups. The poorest black Londoners will receive an average of £870 a year less by 2021-22 – a 5.3 per cent loss – largely as a result of their position on the income distribution.

These findings highlight the importance of understanding the cumulative impact of policy and fiscal changes on the incomes of different household types and groups sharing different characteristics.

Measuring economic fairness issues in the Survey of Londoners

The Mayor of London defines 'economic fairness' as a situation when all Londoners benefit from the city's success, so that opportunity and prosperity are shared.

The Survey of Londoners, a social survey of adults carried out by City Intelligence in conjunction with NatCen Social Research, collected data on several measures of economic fairness, allowing us to analyse the lived economic experience of different groups of Londoners[2].

The measures include Londoners' use of consumer credit and whether they consider servicing their debts to be a burden, insecure employment, access to bank accounts, self-reported fuel poverty, savings and food security. Some of these have never been measured at a London level on this scale, whereas others benefit from the large sample size of over 6,600 respondents that the Survey provides, and allows us to assess with more certainty which groups are more or less likely to be affected.

2 See Survey of Londoners Headline findings

The findings of the Survey support the analysis within the CIA, finding that low income Londoners, single parents, disabled Londoners and Londoners from a Black ethnic background are among the groups most likely to be affected by economic issues.

For example, the Survey asked respondents whether they are able to keep their home warm enough in winter, a self-reported proxy measure for fuel poverty. Overall, around one in eight (12 per cent) of Londoners say they are not able to keep their home warm enough in winter. This figure was substantially higher among those in the lowest income quintile (31 per cent), single parents (27 per cent), disabled Londoners (25 per cent) and those from a black ethnic background (22 per cent).

Among working-age Londoners, we find similar groups are more likely to be in insecure work than the overall average (Figure A2). For example, low-income working-age Londoners are almost twice as likely to be in insecure work.

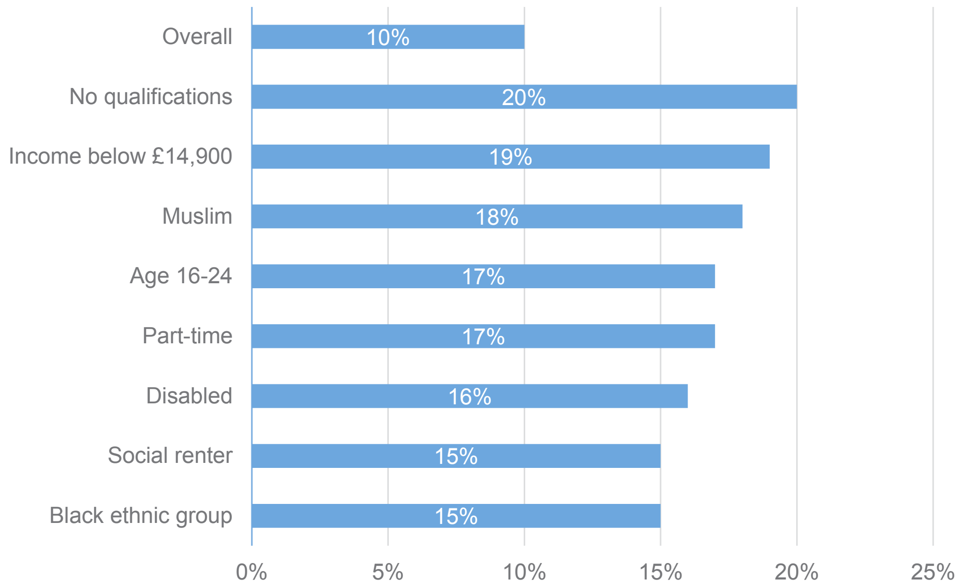


Figure A2: One in ten working-age Londoners in work are in insecure employment

Source: GLA (2019) Survey of Londoners Headline Findings

The food security findings of the Survey also highlight the extent to which some groups are struggling. Being 'food insecure' means that at times a person's food intake is reduced and their eating patterns are disrupted because of a lack of money and other resources for obtaining food.

Overall, around one in five Londoners (21 per cent), equivalent to around 1.5 million adults, have low food security. In terms of the groups who were most likely to experience low food security, these were similar to other Economic Fairness measures – Single parents (46 per cent), Londoners in the lowest income quintile (44 per cent), unemployed Londoners (40 per cent), black Londoners (39 per cent) and disabled Londoners (34 per cent).

The Survey also asked parents a series of questions to assess children's food security. Around one in six (17 per cent) parents in London have children living in low food security. This equates to around 400,000 children.

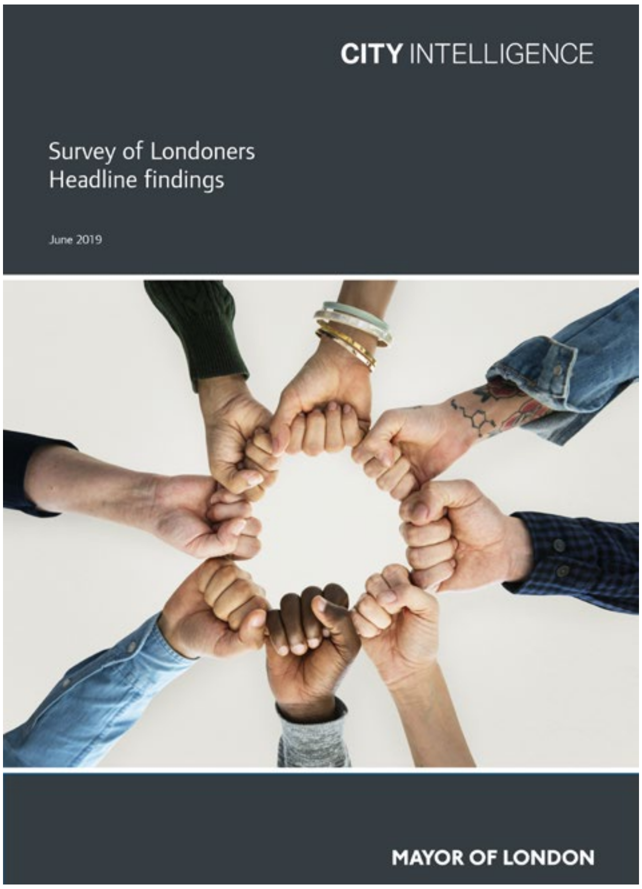
The characteristics of parents whose children had low food security were similar to all adults with low food security with high rates for children whose parents are in the lowest income quintile (41 per cent), children of disabled parents (39 per cent), and children of single parents (36 per cent). Another group with a significantly high rate of 'low food security' despite being a very small group in terms of size, were the children of parents aged 16-24 (70 per cent).

Conclusion

Both the Survey of Londoners and the CIA illustrate just how severe the situation has become for some groups of Londoners. Many Londoners are struggling to keep their homes warm and maintain a consistent food intake, and at the same time are seeing their incomes reduce as a result of national policy decisions.

Both of these analytical projects were developed to fill key gaps in the social evidence base for London. The CIA has cast new light on how tax and welfare policy changes are playing out in the capital, and the Survey of Londoners has collected new data on a range of Mayoral priorities.

Aside from increasing our understanding of the social policy environment in London, the results of these projects are being used to inform the development of policy at City Hall. This includes ensuring that programmes are targeted at those people and places most in need, using this data as a baseline for evaluation, and understanding the links between issues that cut across policy areas, such as economic fairness and social integration.



This work, part of a wider programme to build a social evidence base for London, announced in the Mayor's social integration strategy, will lead to a more thorough evidence-base for social policy in London, and ultimately better outcomes for Londoners themselves.

Download the headline findings from the Survey of Londoners on the London Datastore.

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.

The London input-output tables

This Working Paper (97) shows the first set of published input-output tables for London, and is an important step towards economic accounts for the city:

- The London economy mirrors the UK in terms of the contribution of components of income, expenditure and production to output.
- Unlike the UK a small number of sectors account for much of London's output. These are mainly export-oriented sectors, and with other sectors which enable the movement of people and goods support a trade surplus with the EU, and the rest of the world

Download the full publication.

London's Economic Outlook

Our latest London forecast published in June 2019 suggests that:

- London's Gross Value Added (GVA) growth rate is forecast to be 1.5% in 2019. The growth rate is expected to increase marginally to 1.6% in 2020, before reaching 2.2% in 2021.
- London is forecast to see increases in the number of workforce jobs in 2019, 2020 and 2021.
- 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.

London at night: An evidence base for a 24-hour city

This report brings together a range of research and data on London at night. It reveals that, between 6pm and 6am, the city is buzzing with social, cultural and economic activity.

- A third of everyone working in London works at night – that is 1.6 million people.
- Cost is the main barrier to enjoying culture and leisure activities at night. This is the case across all income groups of Londoners. Over a third of Londoners say it is too expensive to go out at night.

Download the full publication.

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London's Economy Today is published towards the end of every month. It provides an overview of the current state of the London economy, and a selection of the most up-to-date data available. It tracks cyclical economic conditions to ensure they are not moving outside the parameters of the underlying assumptions of the GLA group.

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About GLA Economics
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.

MAYOR OF LONDON