London First Economic Panel
8th May 2008

London Overview – provided by GLA Economics

London's economy was moving in a very strong direction until the second half of 2007 which was seen by some as unsustainable. It is much more volatile than the rest of the UK which was demonstrated in 2001 by the recession which hit London much more severely than the rest of the UK. Although there has been a dramatic fall in London's economic growth since summer 2007, when GVA was increasing at a rate of 4.2% pa, GLA Economics predicts that growth could return to 2.2% by 2010 which is about trend. The down turn could thus be viewed as a correction in the market.

Most agree that 2008 will be a difficult year and caution is being applied in the commercial market as well as, to a lesser extent, in households. Employment levels in London are expected to dip slightly although this is forecast to be a relatively minor fall. Slow growth in household income and spend is expected in 2008 as the cost of living continues to rise due to increasing oil prices affecting energy and food prices.

There is also real concern that the market downturn, coupled with recent proposed UK tax changes, might convince big business to move their headquarters from London; further affecting the local economy.

Employment
GLA Economics forecasts that annual employment growth will fall marginally in 2008 but the decline will be fairly minor in London compared to levels in 2001/02 and in the early 1990s. Recent media reports have warned that the inflow of economic migrants from Eastern Europe may be slowing, leading to further skills shortages, but this is currently largely anecdotal and may more accurately reflect the position outside London.

House price inflation
The sale price expectations of surveyors have fallen significantly with 60% (net) expecting prices to fall. The reality may not be as bad as predictions suggest but it gives a clear message of how badly confidence has been affected.

Manufacturing
Demand for exports is strong and the sector is enjoying a boost due to a weak pound and healthy international demand for goods. Weak trade from the US has been offset by strength elsewhere.

Cost of credit
There exists a big gap between the Bank base rate and the LIBOR rate which has not been affected by the recent reductions in interest rates. There is currently no appetite for inter-bank lending, and concerns over personal debt, coupled with more a cautious approach to lending by banks, has seriously reduced borrowing.

International
London is more heavily dependent on the US than the rest of the UK which is more reliant on European markets. It is therefore feeling the brunt of the US recession and needs the US economy to bounce back to ensure the London economy moves back into positive territory in 2009. The depreciation of Sterling compounded with a dramatic rise in global oil prices is putting pressure on some sectors.

The London Economy – by sector

1. Financial

The overall picture is seen as mixed. The main factor defining how financial institutions are performing is liquidity. There is evidence that more risky, large scale deals are slowing but there is still, perhaps surprisingly, availability of credit in places. The demand for borrowing could be interpreted as having stalled as a more cautious attitude prevails across the market. There is a sense that the business community is waiting for something to happen which hasn't quite yet.

The press coverage of the post-'credit-crunch' effects on the average person and the UK's debt to income ratio has potentially concealed a far more subtle picture. The UK has a wide distribution where there are those with unsustainable debt to income ratios of up to 160% but, equally, there are many with 0% whose spending power remains stable. Additionally, whilst household costs have undoubtedly risen in the past few years, and appear to continue to do so, these costs are spread across usually two or more working family members.

It is possible to see the demise of the small number of aggressive lenders as a positive market correction. Although this number was always very limited, the damage they caused was disproportionate to their share of the market, and the risks involved can perhaps now be more sensibly priced.

There is currently huge political pressure to insist that banks boost their reserves, in an attempt prevent future crises, and banks are likely to face greater scrutiny and regulation in future.

2. Commercial property

The hit to the commercial property sector in 2007, as with the domestic construction industry, was dramatic and has continued well into 2008. Rents are falling across the capital and funding for highly geared new developments is almost impossible gain at present. Developers without 20-30% equity have been frozen out of the market. The West End has been more resilient to falls in rental values than the City, and was strong for the in the first quarter of 2008, but it is predicted that even this strong letting market will fall at least 10% in 2008.

There is a sense that there is no shortage of potential cash buyers, both locally and abroad, yet this is offset by a prevailing belief that prices may yet fall further.

The question everyone is asking is when will the buyer come back? As long as assets sit in bank accounts, as potential buyers wait for confidence to return, growth in property development will slow or even stop. The silver lining is in the rich opportunities available in the meantime for those with tenacity and the availability of cash.

3. Professional services

Other than property and construction firms, most businesses appear fairly strong, although there is evidence that there is slower growth in discretionary spending (see also hospitality sector). There is a much reduced volume of private equity deals but demand for mid-sized deals has returned, albeit with significantly less leverage which has implications for valuations.

There has been an increase in company receiverships but this has not been dramatic.

4. Hospitality & leisure

The outlook for the hospitality sector is positive with healthy occupancy, particularly at the highest end of the market, which has been untouched so far. The indications are that behaviour of the very wealthy has been unaffected by the recent economic turmoil and growth in the sector for 2008 is expected, though at a slighter lower rate than in 2007 over 2006. The main sign of any financial uncertainty is in corporate activity. Conference bookings are slightly affected although the indications are that this is a cautious rather than needs-must approach.

Leisure bookings at large-scale venues remain strong with good numbers of corporate and non-corporate visitors.

5. Information and technology

The IT sector is in very good shape. The service aspect of the market is growing along with large increases in data storage needs. As business relies more heavily on technology it has become more critical that there is adequate resilience and protection in place to safeguard it.

As the appetite for green technologies increases so too do the opportunities for the IT sector to use to its advantage.

The challenges facing the sector are much less concerned with demand or confidence but with the ability to provide good access for the huge number of users through fast broadband infrastructure. Another serious issue for the industry is the lack of availability of skilled workers at every level. Employers are looking for individuals that can not only innovate or design state-of-the-art technologies, but those with much-needed 'soft' skills.

6. Aviation

Oil prices are dominating the air travel industry and the challenge for competitive airlines is to operate at a profit. There is also a worldwide shortage of upgraded fleets which is putting pressure on airlines.

Niche business-traveller carriers are going out of business, largely because they are unable to provide the frequencies required. The domestic market is catering largely for the business traveller, flying from the regions to join a connection at a London airport.

Demand for flying remains robust despite concerns about environmental issues.

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