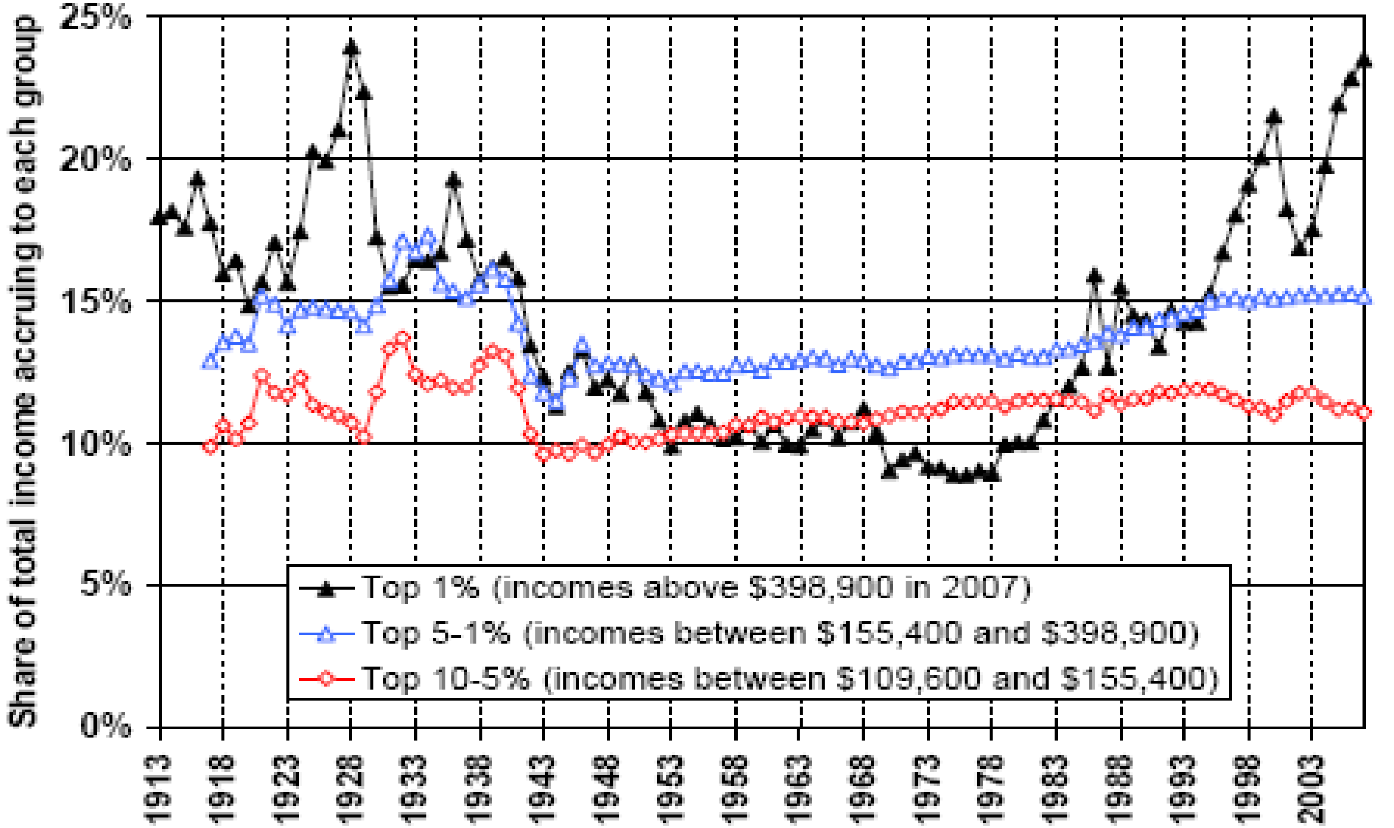
Perfect or not ? The financial markets and the Globalization process

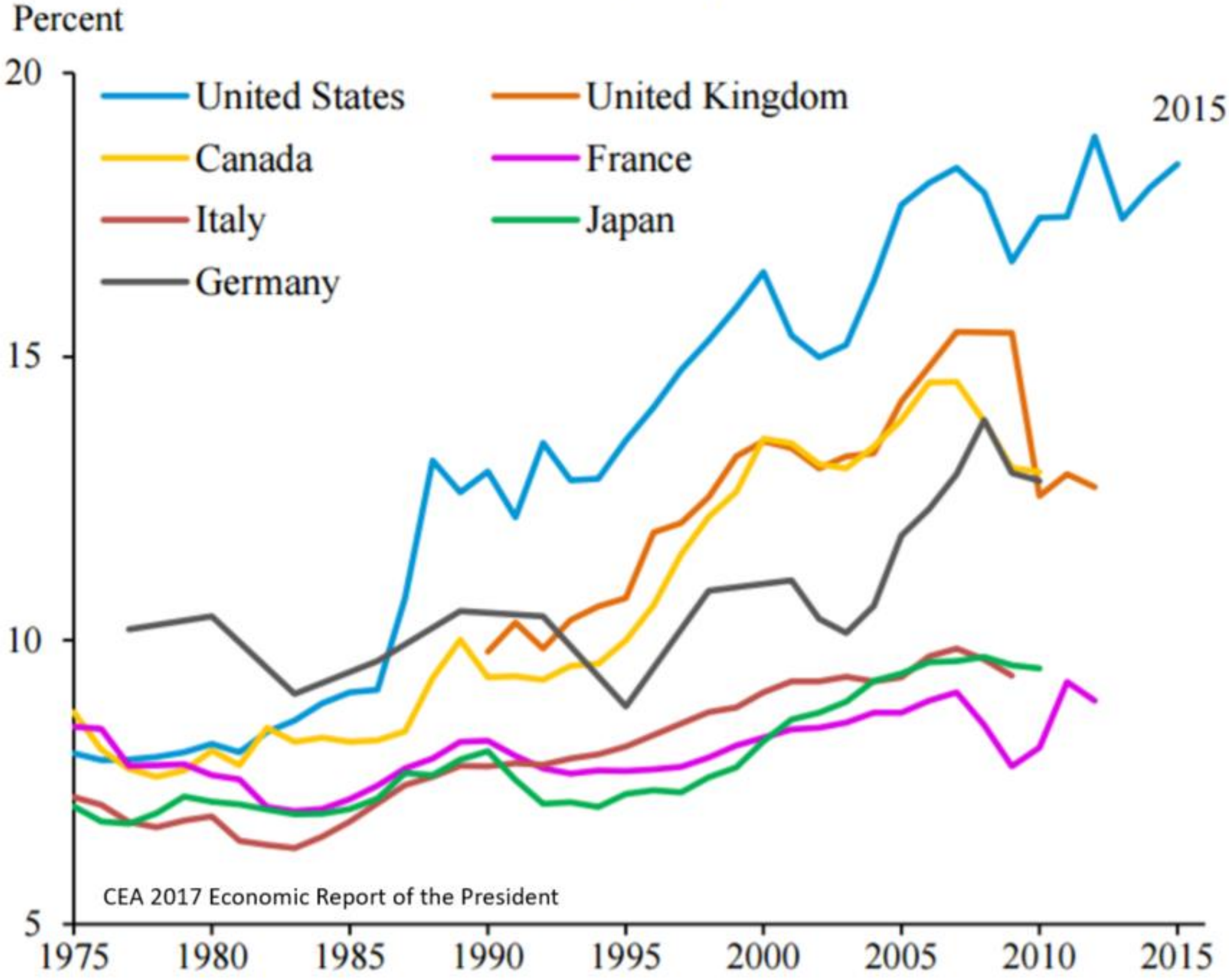
Financialization: definition

- “Financialization means the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies” (Epstein 2006)

The social and economic consequences



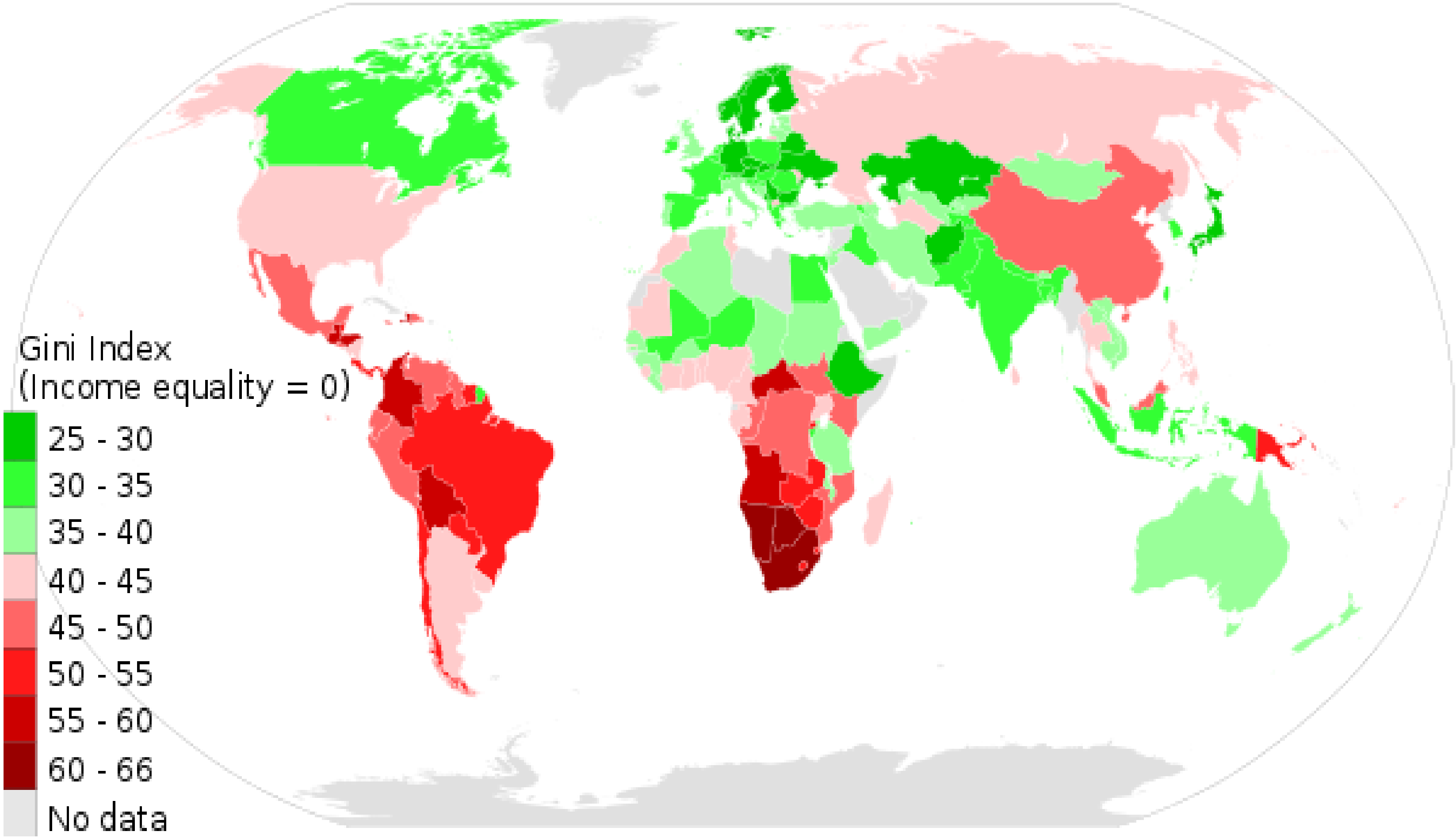
Share of Income Earned by Top 1 Percent, 1975–2015



CEA 2017 Economic Report of the President

Source: World Wealth and Income Database.

Global inequalities



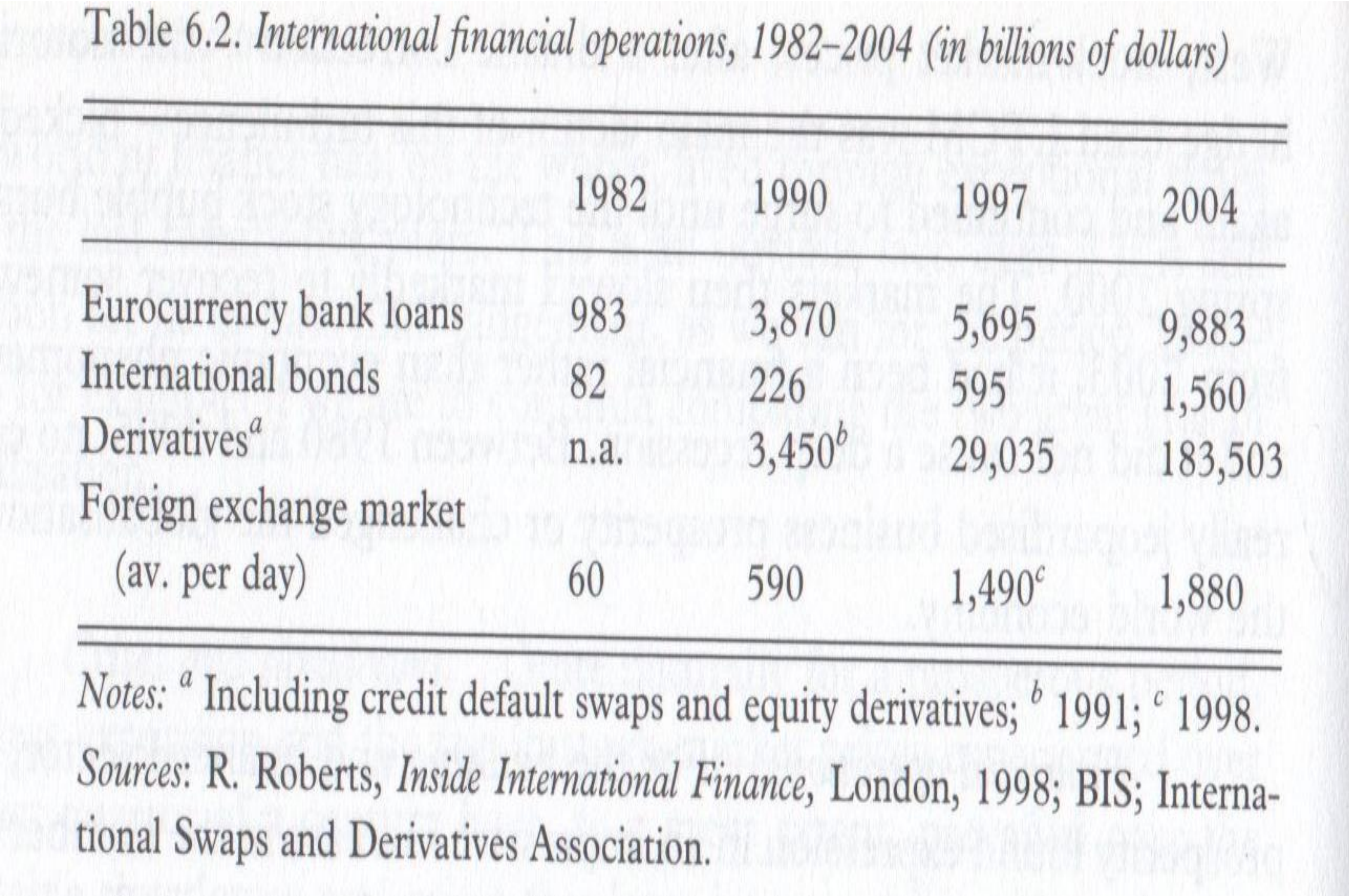


Table 6.2. *International financial operations, 1982–2004 (in billions of dollars)*

	1982	1990	1997	2004
Eurocurrency bank loans	983	3,870	5,695	9,883
International bonds	82	226	595	1,560
Derivatives[a]	n.a.	3,450[b]	29,035	183,503
Foreign exchange market (av. per day)	60	590	1,490[c]	1,880

Notes: [a] Including credit default swaps and equity derivatives; [b] 1991; [c] 1998.

Sources: R. Roberts, *Inside International Finance*, London, 1998; BIS; International Swaps and Derivatives Association.

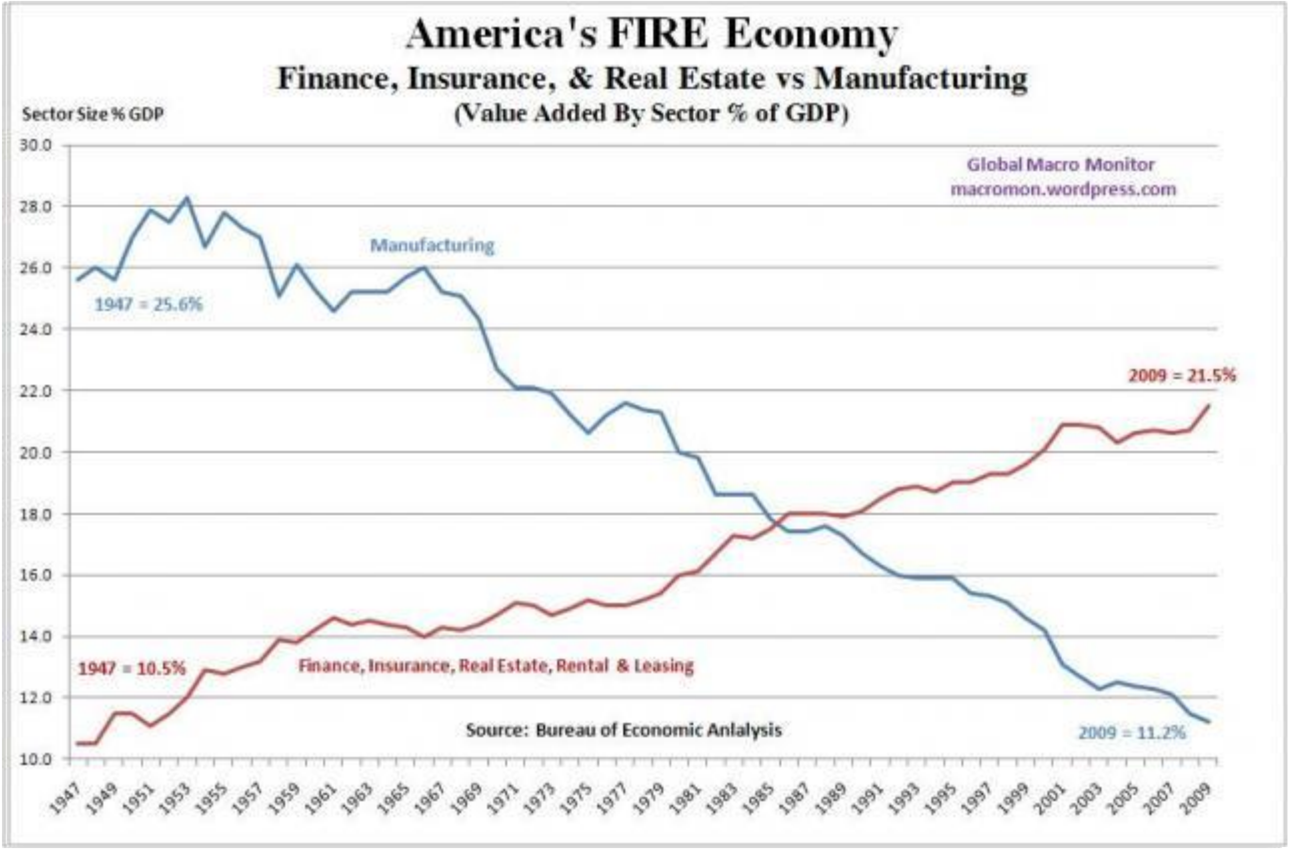
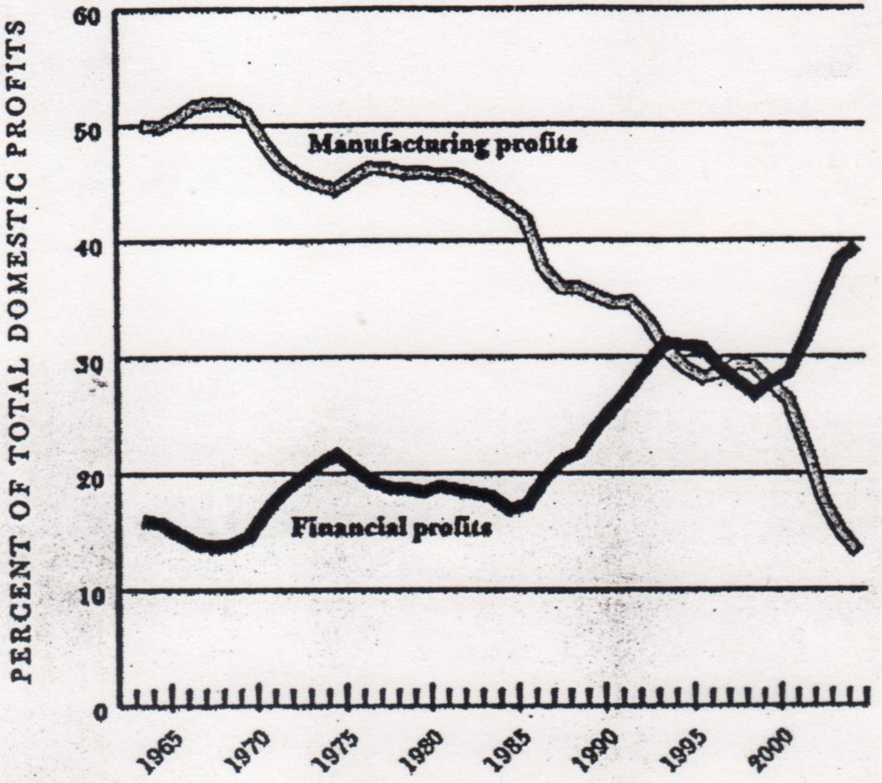
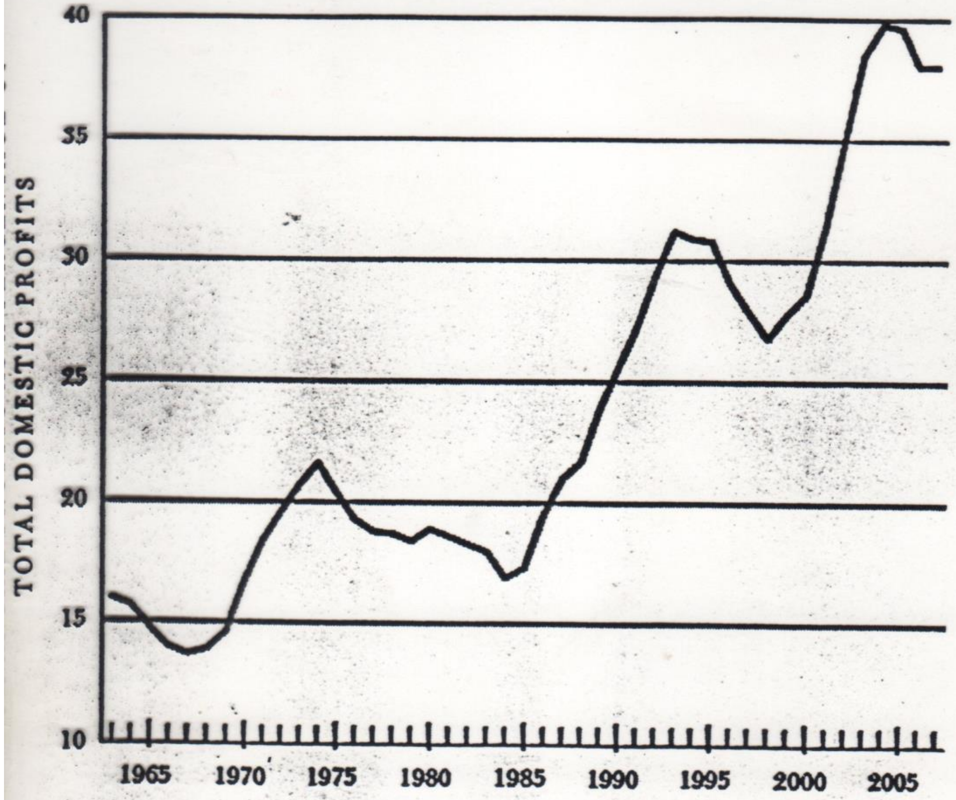

America's FIRE Economy
Finance, Insurance, & Real Estate vs Manufacturing
(Value Added By Sector % of GDP)
Sector Size % GDP
30.0
28.0
26.0
24.0
22.0
20.0
18.0
16.0
14.0
12.0
10.0
Global Macro Monitor
macromon.wordpress.com
Manufacturing
1947 = 25.6%
2009 = 21.5%
1947 = 10.5%
Finance, Insurance, Real Estate, Rental & Leasing
Source: Bureau of Economic Anlalysis
2009 = 11.2%
1947
1949
1951
1953
1955
1957
1959
1961
1963
1965
1967
1969
1971
1973
1975
1977
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
2009

CHART 2.4: *Five-Year Running Average of Manufacturing and Financial Sectors as a Percent of Domestic Profits*

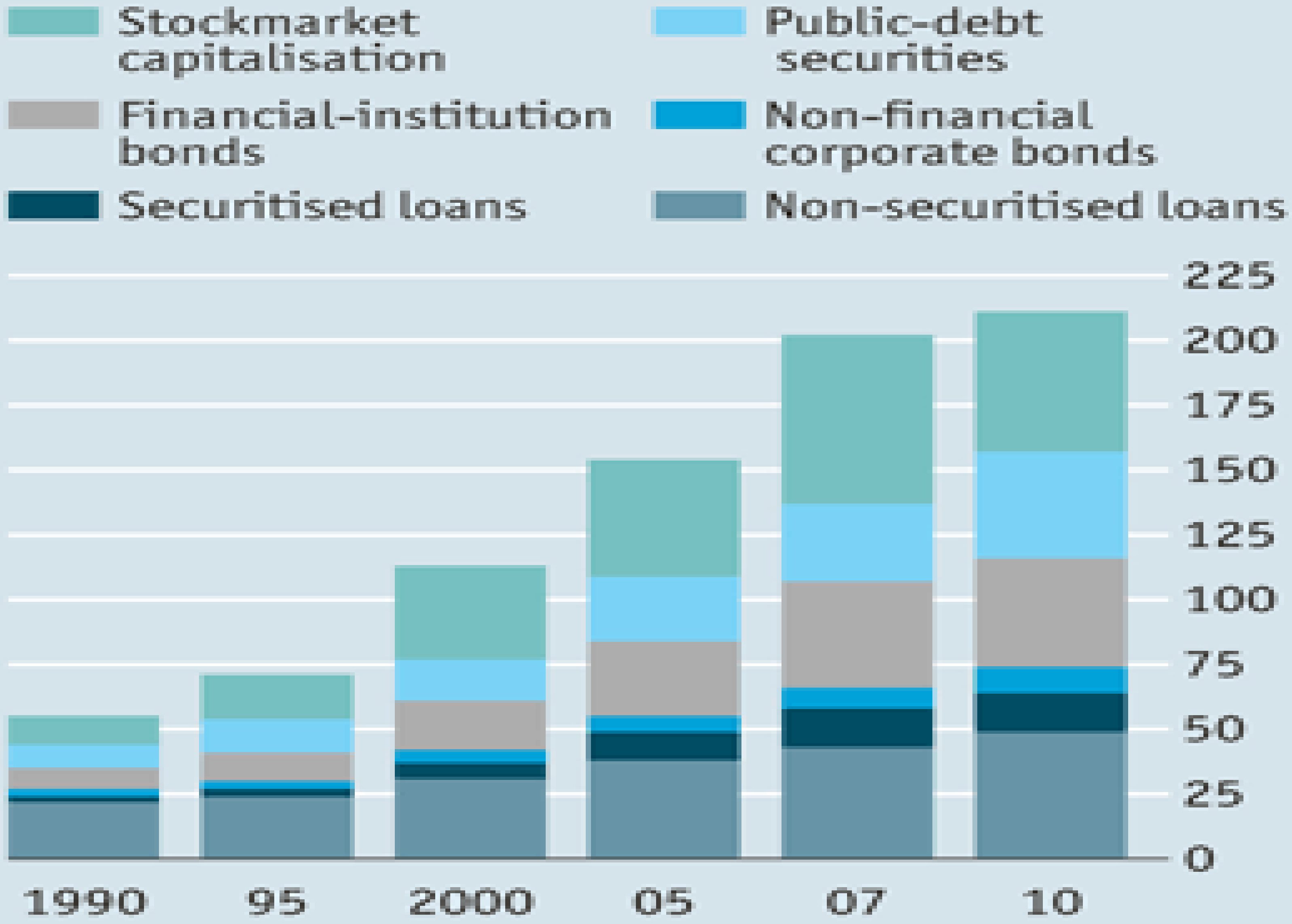


HART 5.1: *Financial Profits as a Percentage of Total Domestic Profits (five-year moving average)*



Global financial assets

Amounts outstanding*, $trn



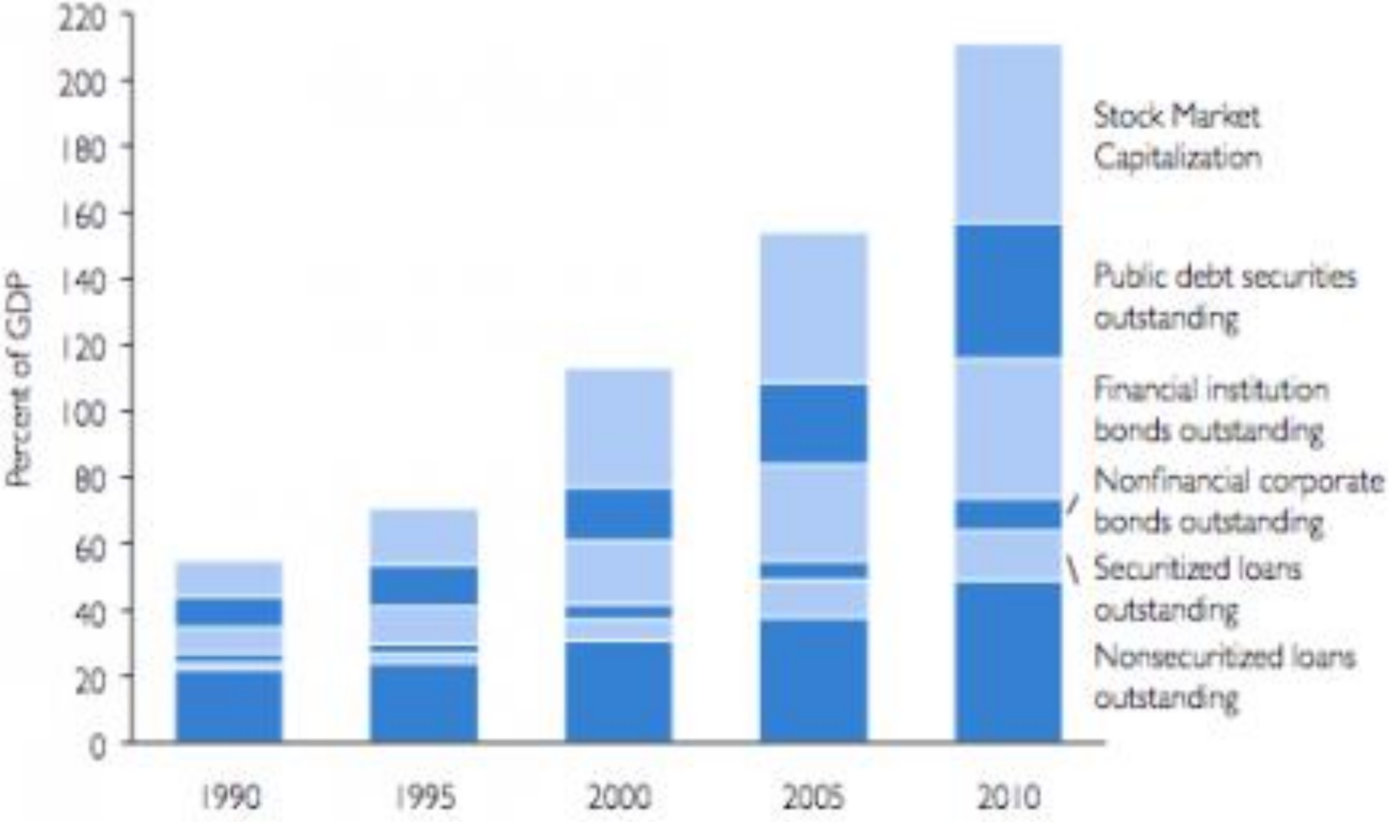
Source: McKinsey Global Institute

*Among 79 countries

Exhibit 1

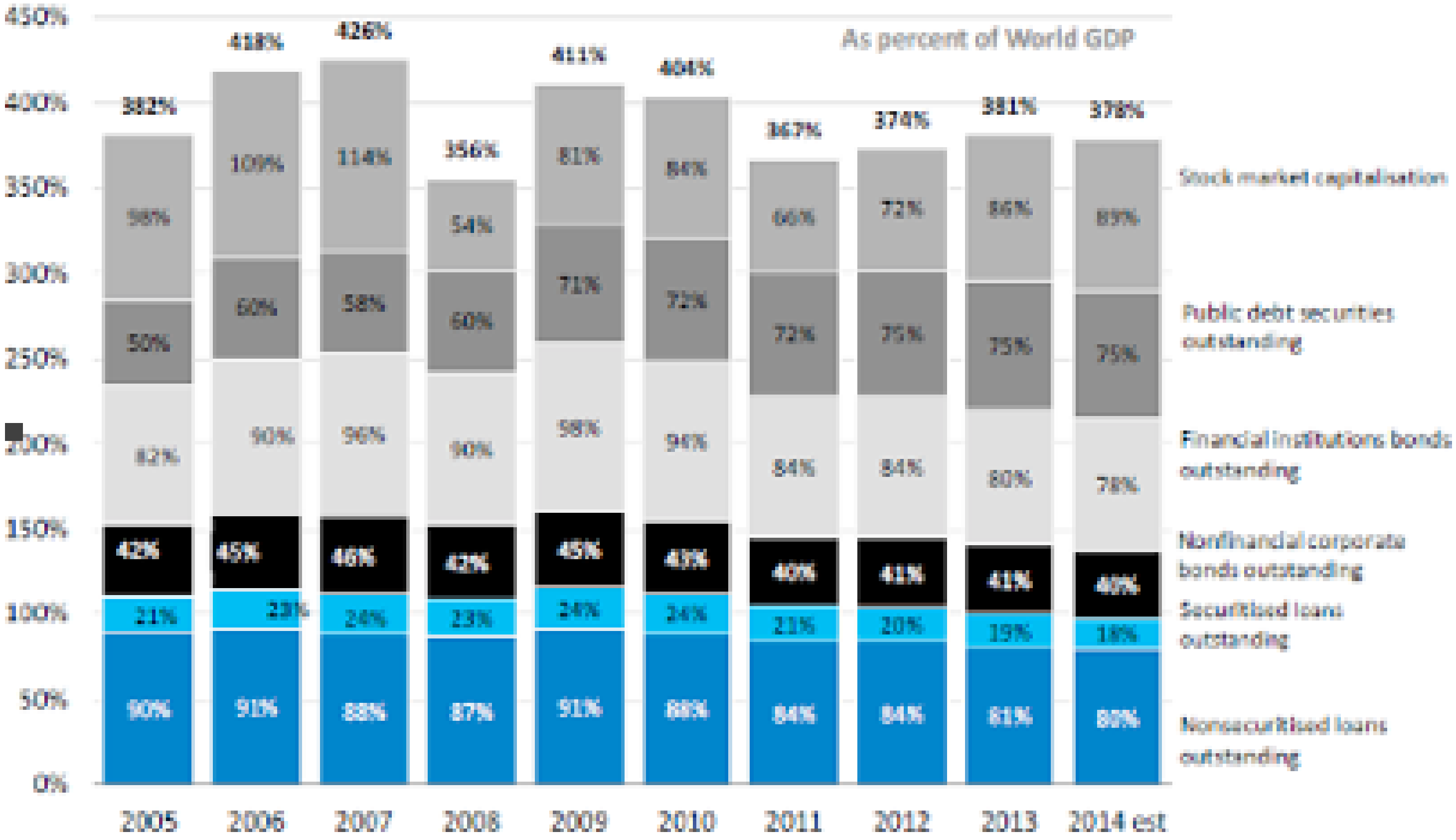
THE GLOBAL STOCK OF FINANCIAL ASSETS HAS GROWN 4 TIMES THE RATE OF GDP OVER THE PAST 20 YEARS

Global Financial Stock as a Percent of Global GDP



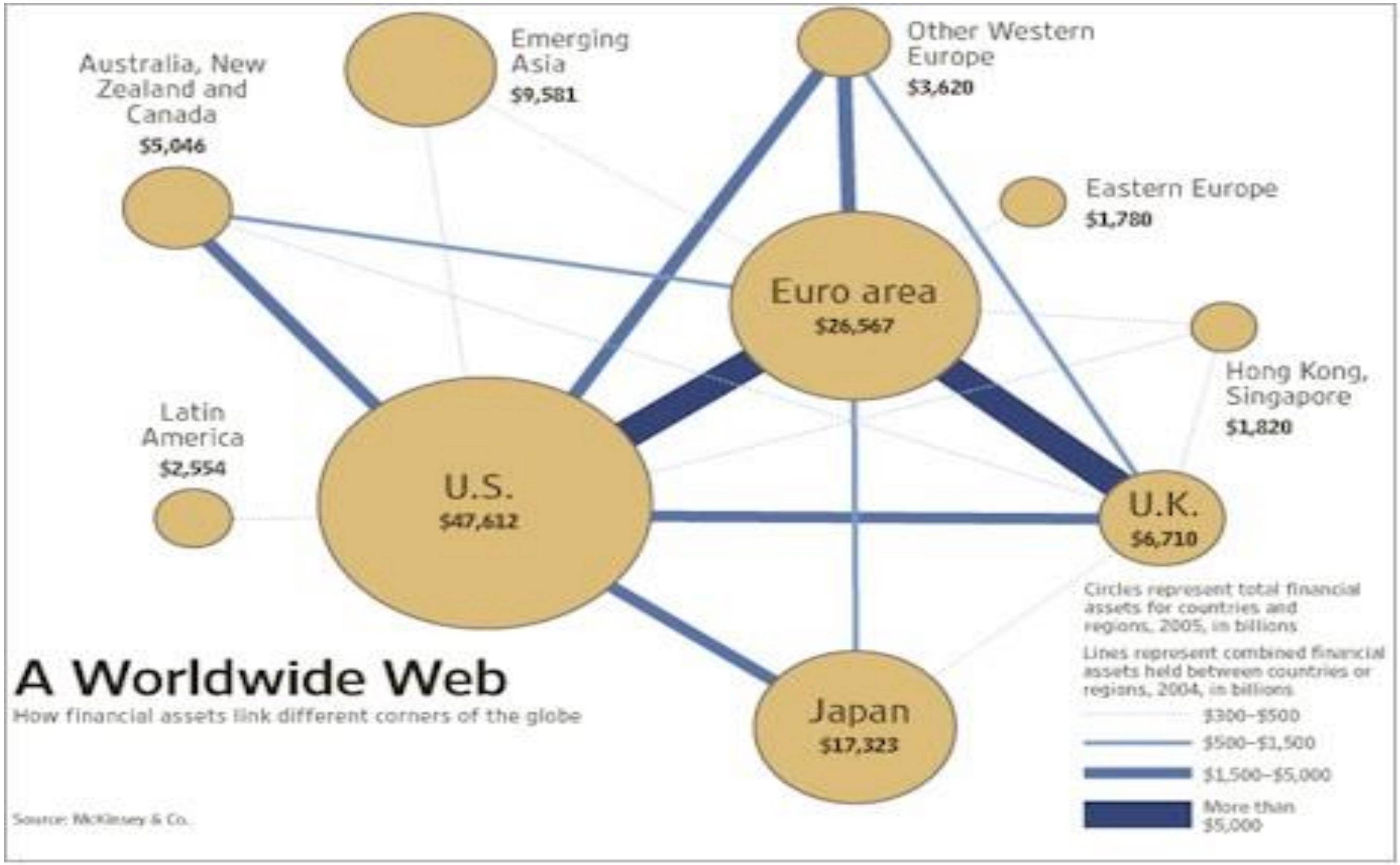
Source: McKinsey Institute

Figure 2: Stock of Global Financial Assets as % of Global GDP



Source: McKinsey Global Institute, Haver, BIS, DB estimates, IMF

A very much integrated financial market



A Worldwide Web

How financial assets link different corners of the globe

Source: McKinsey & Co.

Circles represent total financial assets for countries and regions, 2005, in billions

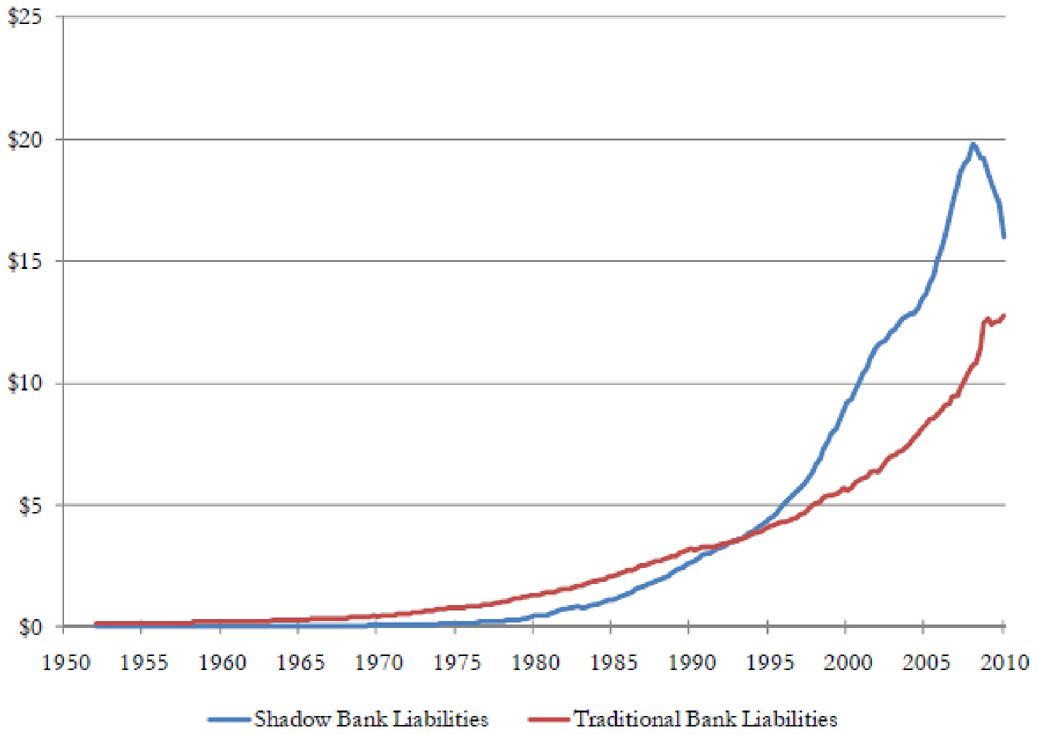
Lines represent combined financial assets held between countries or regions, 2004, in billions

- **What about the shadow**
- **banking system ?**
- intermediate credit through a wide range of securitization and secured funding techniques such as asset-backed commercial paper (ABCP), asset-backed securities (ABS), collateralized debt obligations (CDOs) and repurchase agreements (repos)

- **The gross measure of shadow bank liabilities grew to a size of nearly $22 trillion in June 2007**

- **We also plot total traditional banking liabilities in comparison, which were around $14 trillion in 2007**

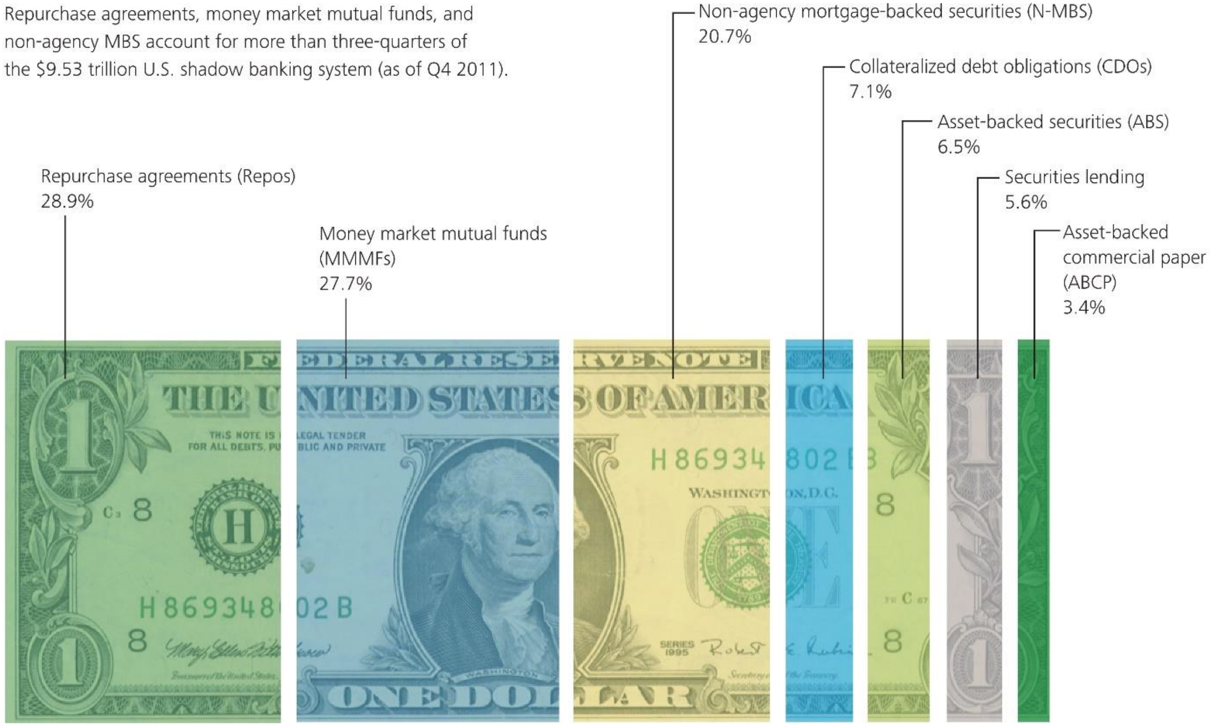
Figure 1: Shadow Bank Liabilities vs. Traditional Bank Liabilities, *$ trillion*[4]



Source: Flow of Funds Accounts of the United States as of 2010:Q1 (FRB) and FRBNY.

Adding up: Seven components comprise the Deloitte Shadow Banking Index

Repurchase agreements, money market mutual funds, and non-agency MBS account for more than three-quarters of the $9.53 trillion U.S. shadow banking system (as of Q4 2011).



(known)

US$ 1.44 Quadrillion

Shadow banking system

(off balance)

(known)

US$ 706 Trillion

Shadow banking system

(off balance)

US$ 65 Trillion

Real banking system

(on balance)

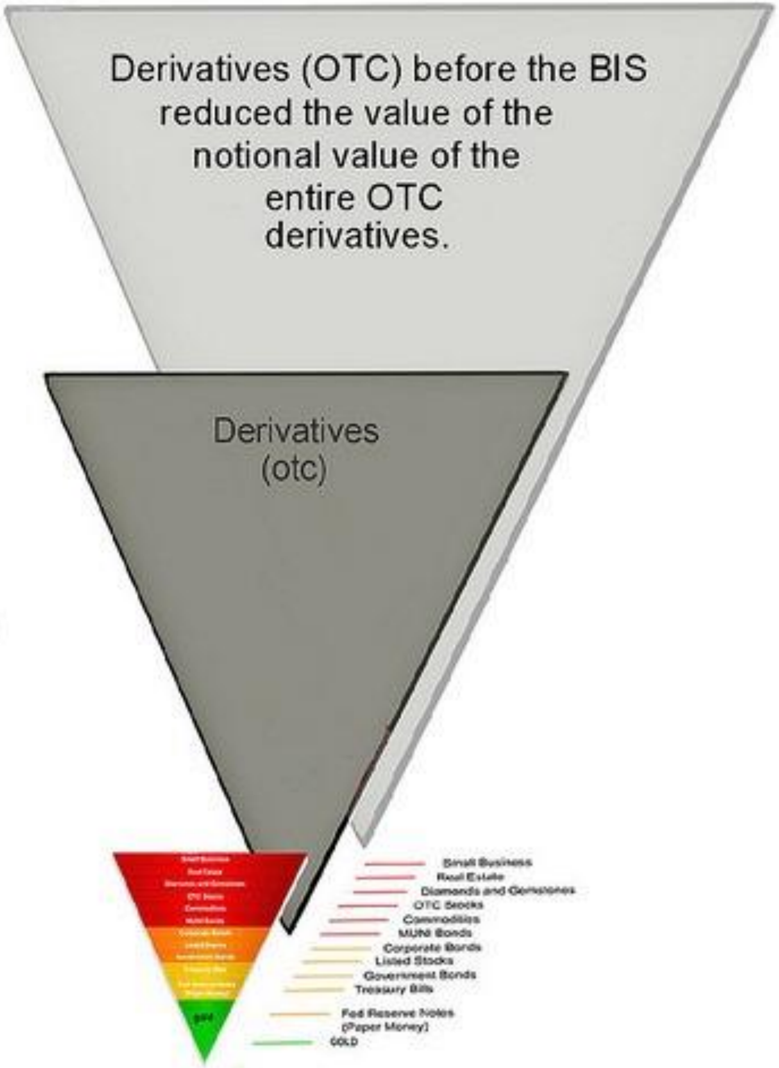
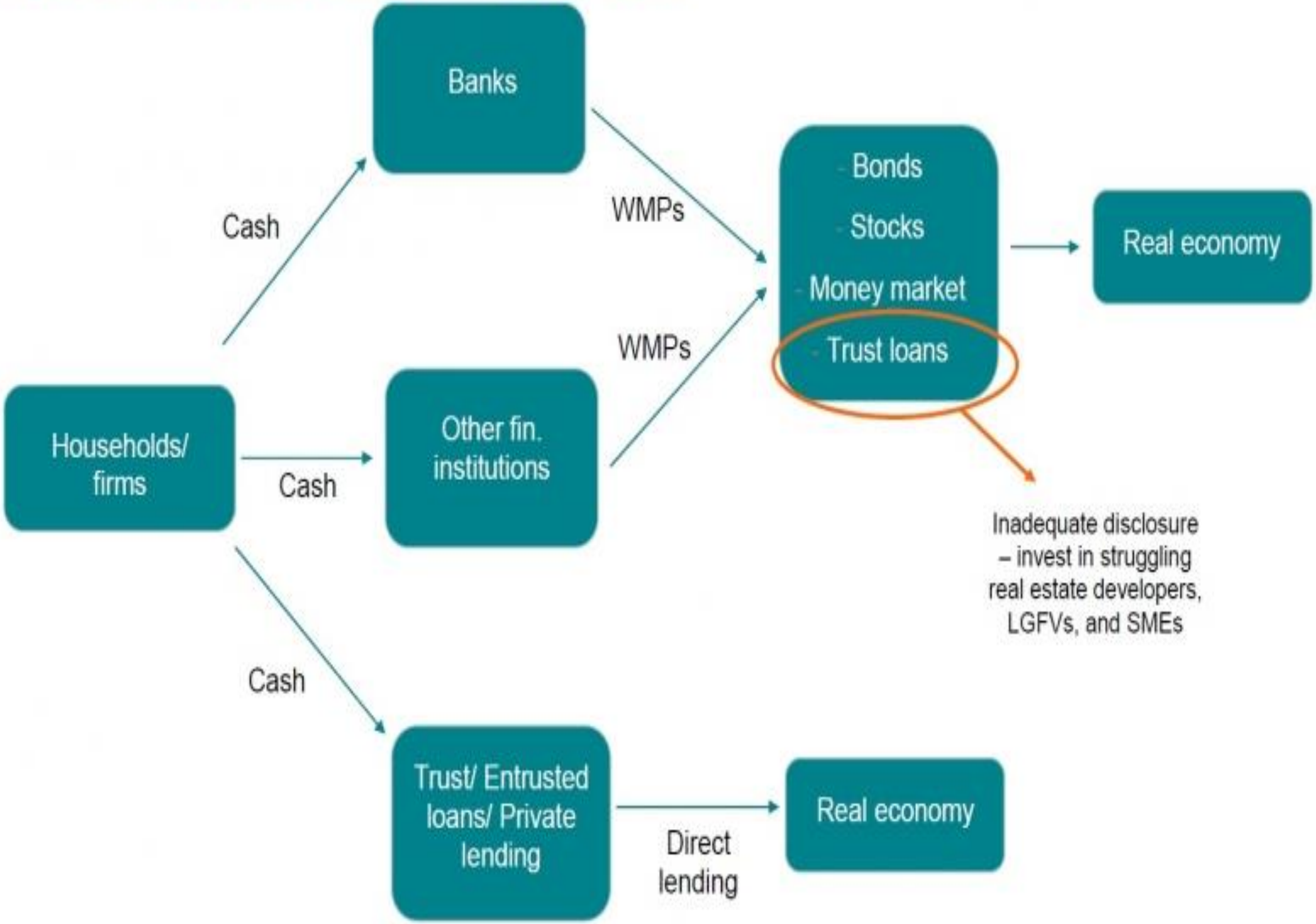


Figure 35: How does the shadow banking system work?



Source: Exane BNP Paribas estimates

Hedge Fund Assets under Management and Number of Hedge Funds, 1950-2005[63]

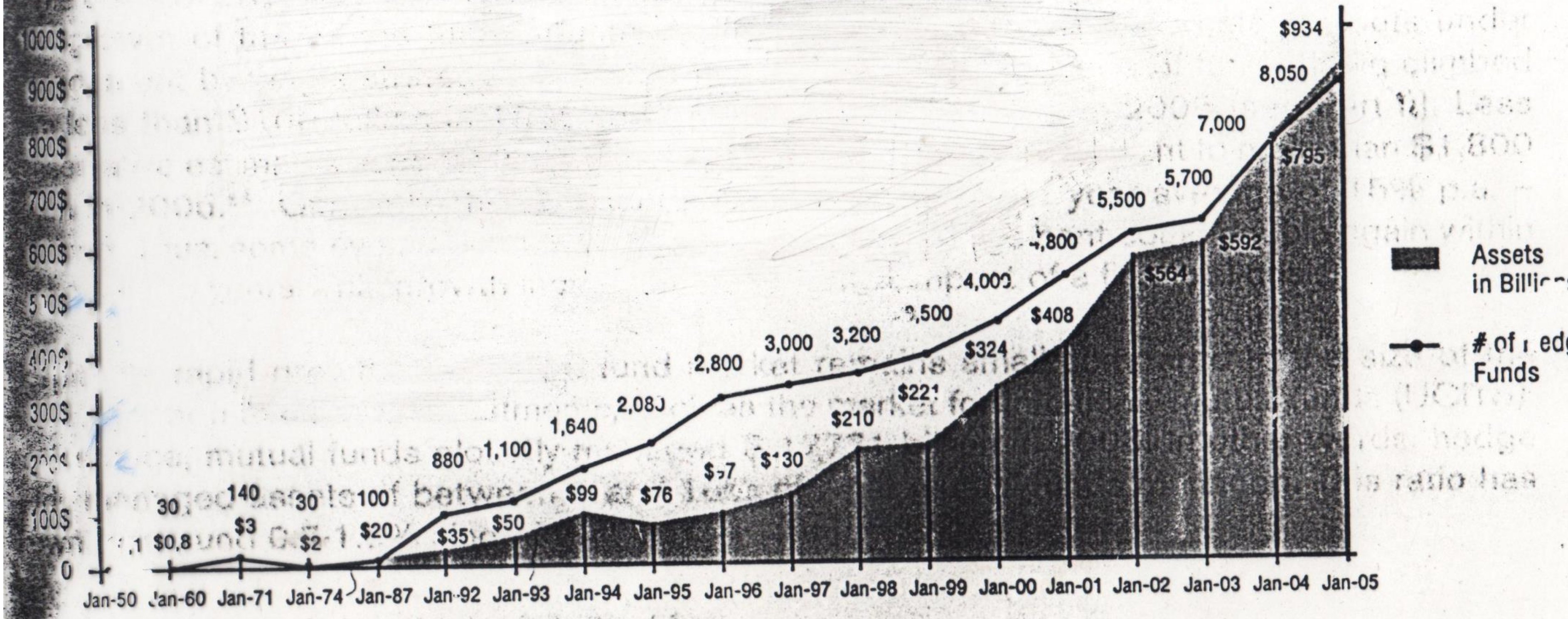
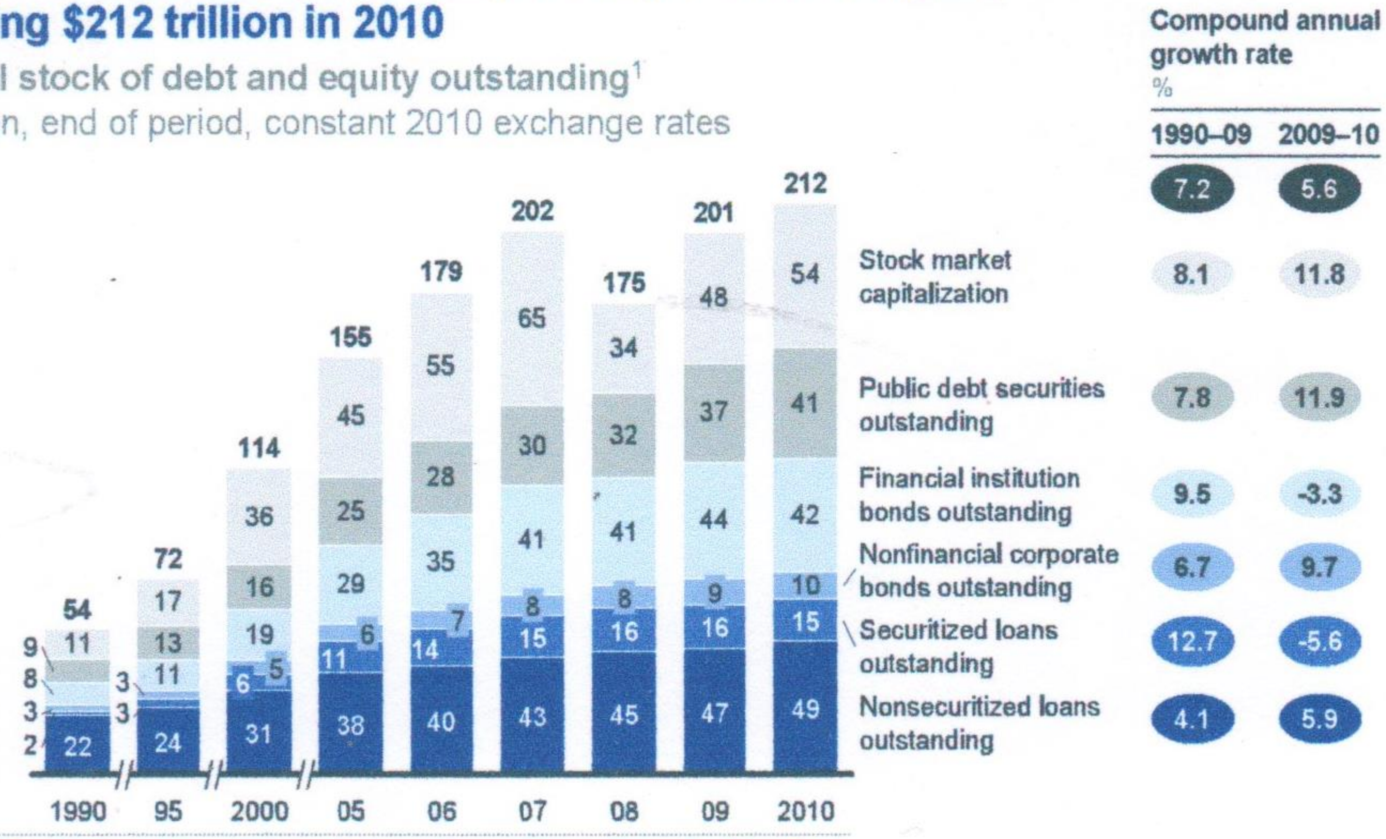


Exhibit 1

Global financial stock has surpassed pre-crisis heights, totaling $212 trillion in 2010

Global stock of debt and equity outstanding[1]

$ trillion, end of period, constant 2010 exchange rates



	1990	95	2000	05	06	07	08	09	2010
Financial depth[2] (%)	261	263	321	334	360	376	309	356	356

1 Based on a sample of 79 countries.

2 Calculated as global debt and equity outstanding divided by global GDP.

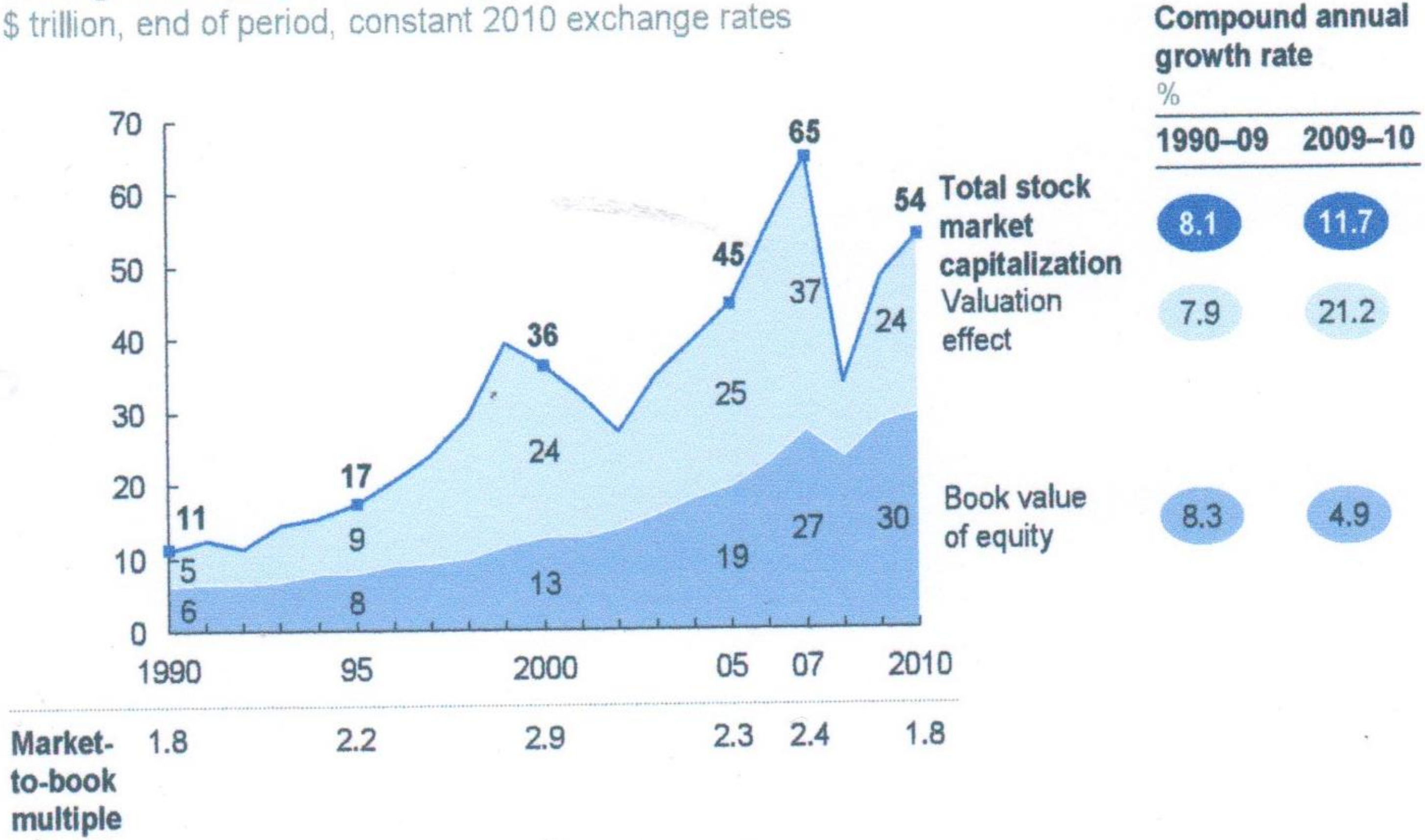
NOTE: Numbers may not sum due to rounding.

SOURCE: Bank for International Settlements; Dealogic; SIFMA; Standard & Poor's; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Exhibit 2

Swings in valuation levels are responsible for most of the fluctuations in global equity outstanding

Total global equity outstanding[1]
$ trillion, end of period, constant 2010 exchange rates



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1 Calculated based on yearly country-specific market-to-book multiple.

NOTE: Numbers may not sum due to rounding.

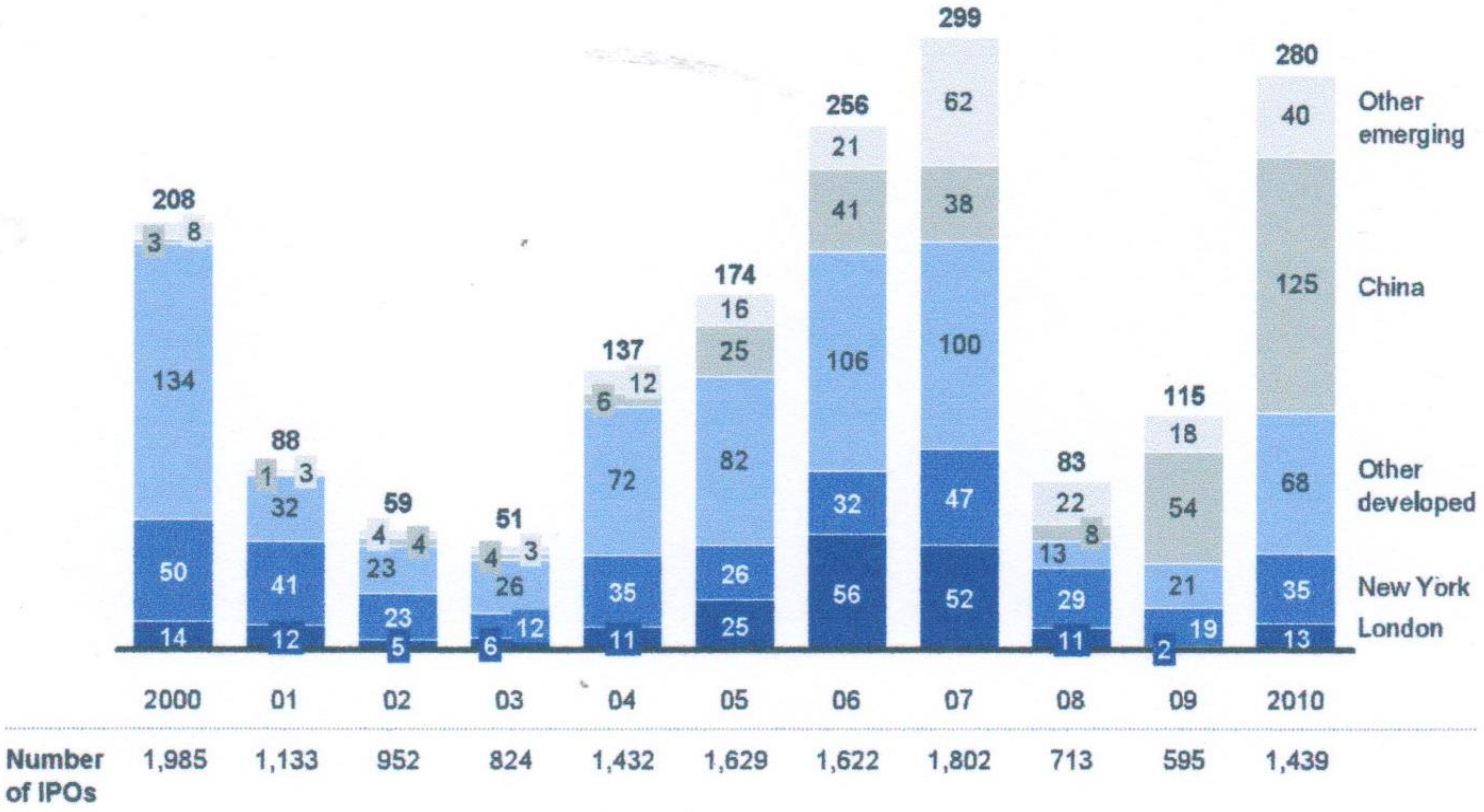
SOURCE: Standard and Poor's; Datastream; Bloomberg; McKinsey Corporate Performance Analysis Tool (CPAT); McKinsey Global Institute analysis

Exhibit 4

More than half of global IPO volume occurred on emerging market exchanges in 2009 and 2010

Deal volume in different stock exchange locations

$ billion

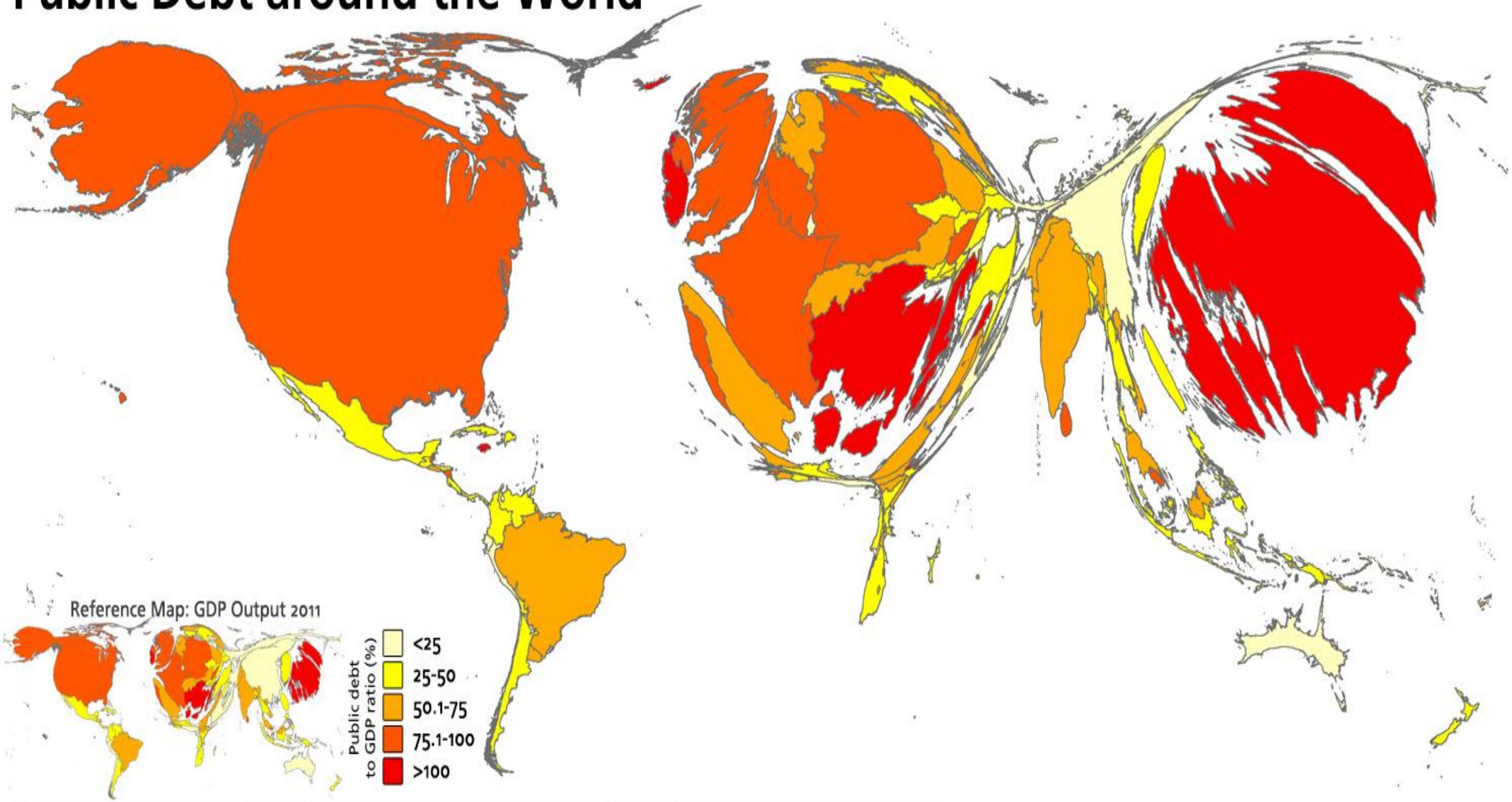


NOTE: Numbers may not sum due to rounding.

SOURCE: Dealogic; McKinsey Global Institute analysis

$54 Trillion

Public Debt around the World



Data Sources: Compiled from IMF, World Economic Outlook Database 04/2011, with additional data from IMF & EUROSTAT
Map created by Benjamin D. Hennig, Sasi Research Group, University of Sheffield

www.viewsoftheworld.net

UNITED NATIONS OF DEBT

HOW MUCH GOVERNMENT DEBT EXISTS?

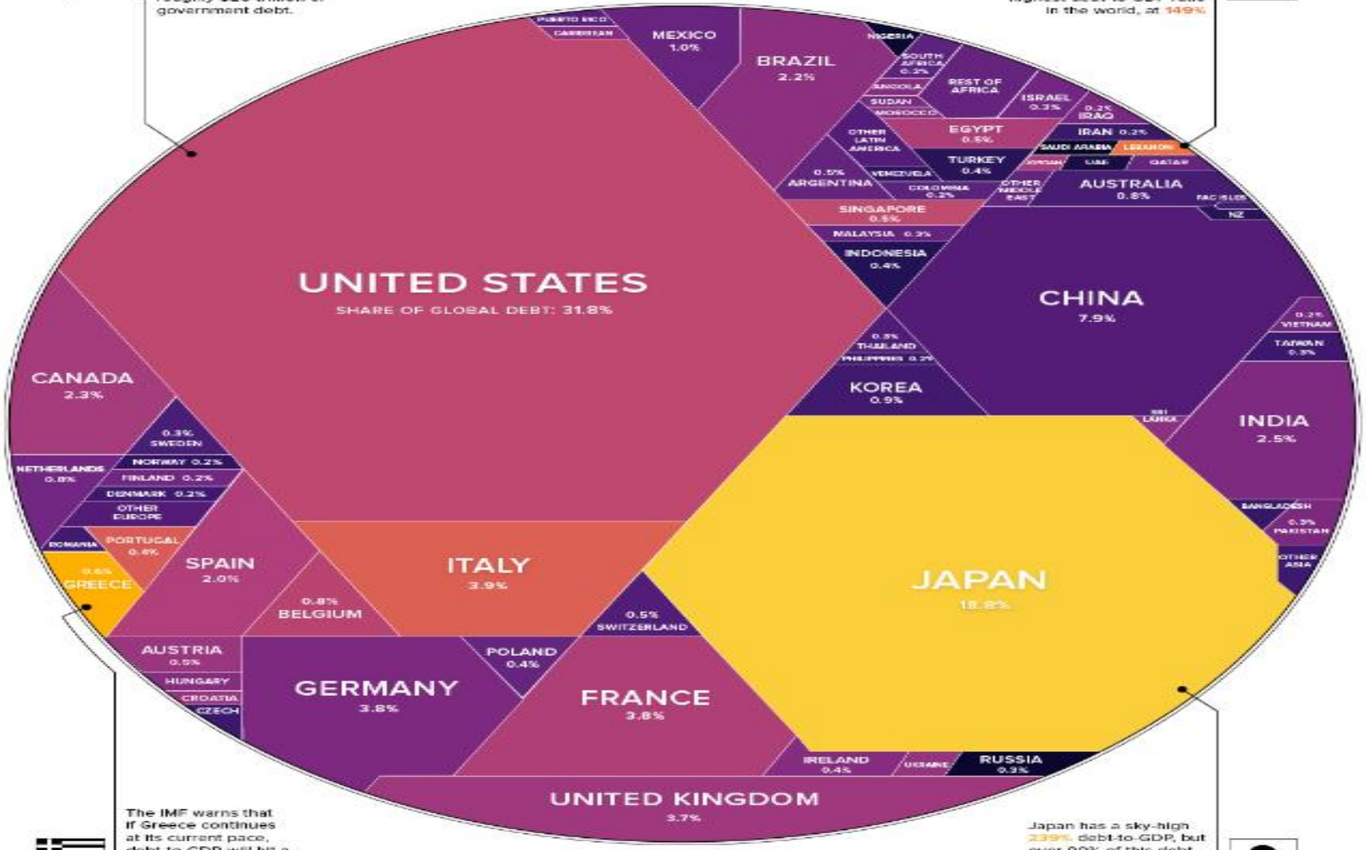
According to most recent estimates by the IMF, governments have accumulated **$63 trillion** in total - and the U.S. makes up almost a third of that amount.

Percentage of World Debt

BY COUNTRY

In nominal terms, the U.S. leads the world with roughly **$20 trillion** of government debt.

Lebanon, perhaps surprisingly, has the 3rd highest debt-to-GDP ratio in the world, at 149%



The IMF warns that if Greece continues at its current pace, debt-to-GDP will hit a whopping 275% by 2060.

Japan has a sky-high 239% debt-to-GDP, but over 90% of this debt is held domestically.

Debt as a Percentage of GDP

VISUAL CAPITALIST

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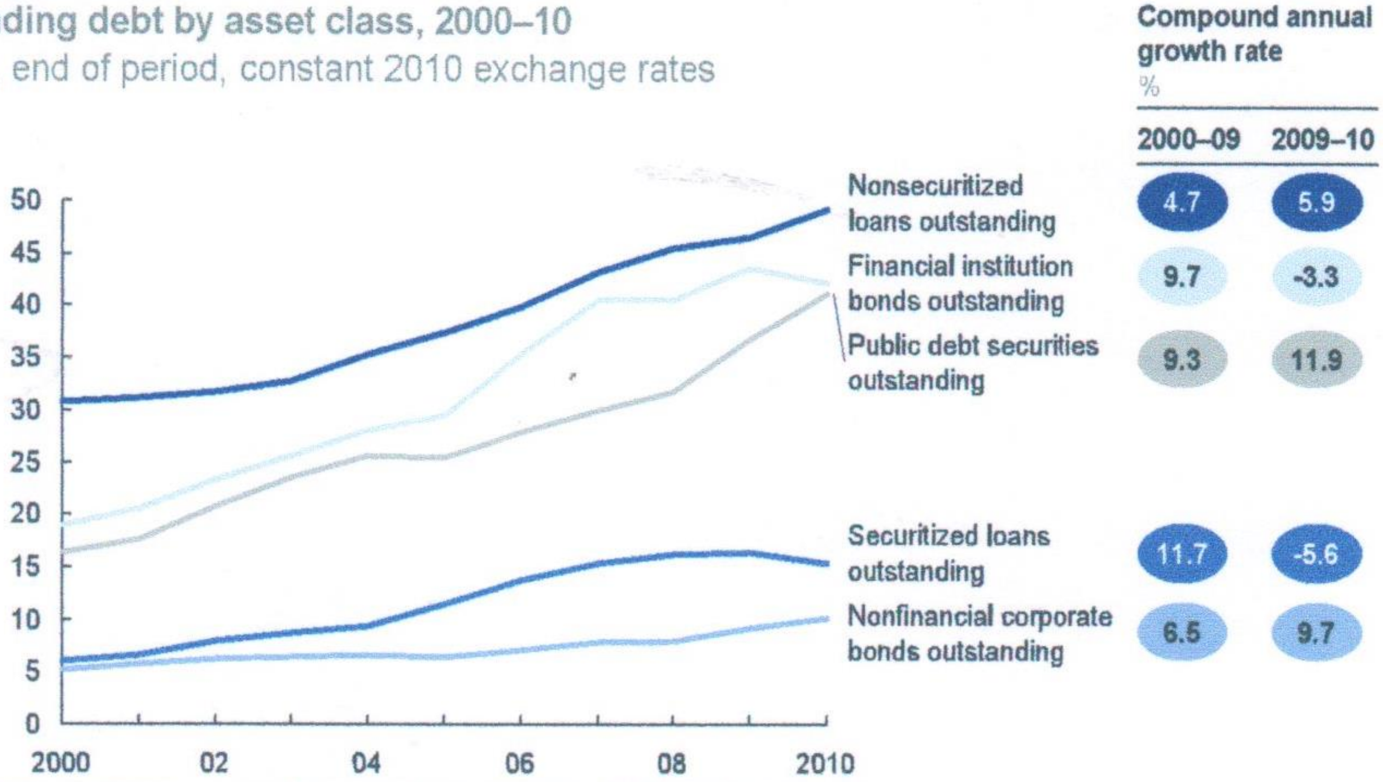
Rank	Country	Debt-to-GDP ratio
1	Japan	236
2	Greece	191.4
3	Sudan	176.5
4	Venezuela	163
5	Lebanon	157.4
6	Italy	129.8
7	Eritrea	129.5
8	Barbados	128.8
9	Yemen	128.3
10	Cabo Verde	124.8

Exhibit 5

Growth in public debt continued in 2010, but nonsecuritized loans remain the largest class of debt

Outstanding debt by asset class, 2000–10

$ trillion, end of period, constant 2010 exchange rates



Global debt[1]

$ trillion	77.6	90.3	105.5	123.9	141.8	158.1
% GDP	218	235	242	249	250	266

[1] Sum of financial institution bonds outstanding, public debt securities outstanding, nonfinancial corporate bonds outstanding, and both securitized and nonsecuritized loans outstanding.

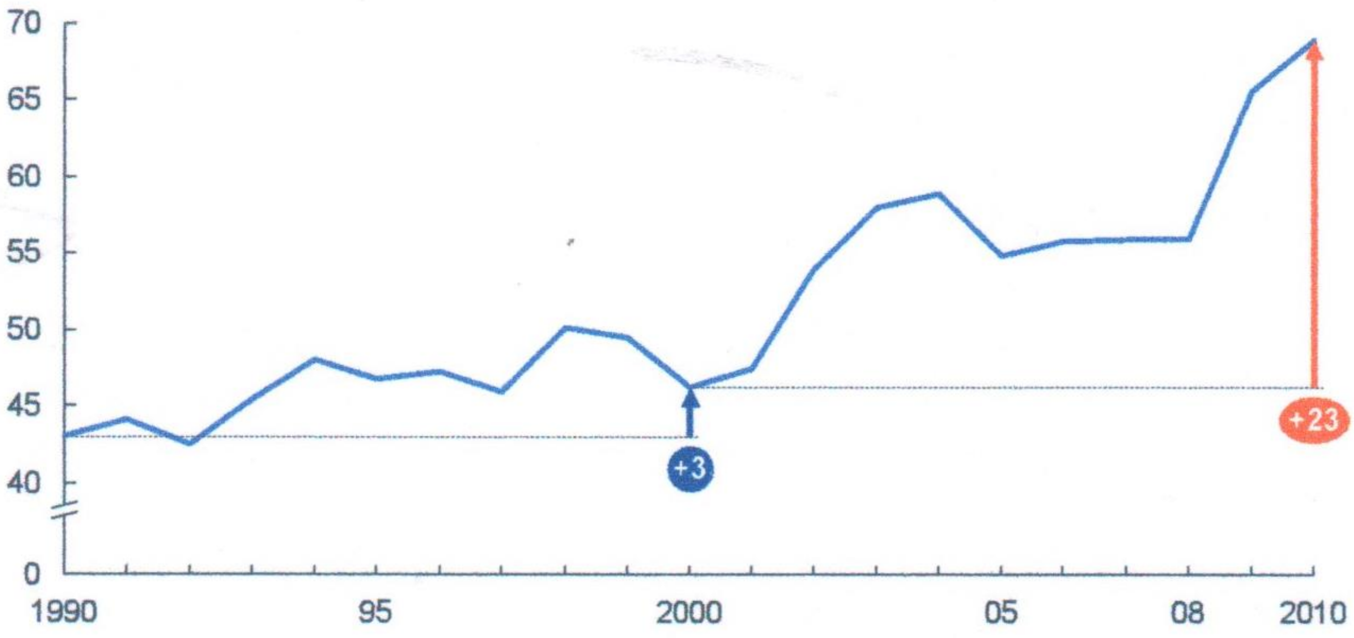
SOURCE: Bank for International Settlements; Dealogic; SIFMA; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Exhibit 9

Global public debt has increased by $24.6 trillion over the last decade, reaching 69 percent of GDP in 2010

Gross outstanding public debt[1] as % of GDP

%, end of period, constant 2010 exchange rates



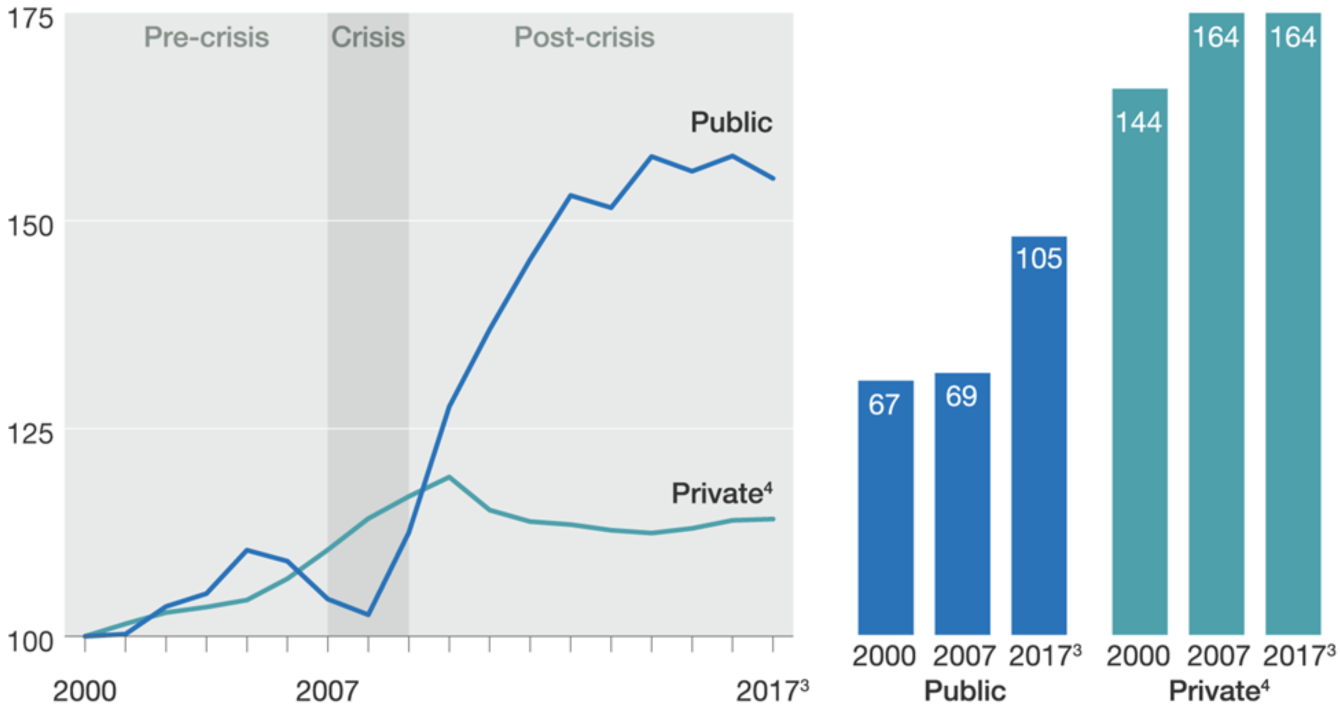
Public debt total $ trillion	8.9	12.8	16.5	25.4	31.7	41.1

---

[1] Defined as general government marketable debt securities; excludes government debt held by government agencies (e.g., US Social Security Trust Fund).

SOURCE: Bank for International Settlements; McKinsey Global Institute analysis

Public debt increased rapidly after the crisis in advanced economies.



Debt in advanced economies[1] by sector,
% of GDP,[2] Index: 100 = 2000

Actual debt-to-GDP ratio in advanced economies, %

[1] Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, United Kingdom, and United States.
[2] Debt as percent of GDP is indexed to 100 in 2000; numbers are not actual figures.
[3] First half of 2017.
[4] Includes household and nonfinancial corporate-sector debt.

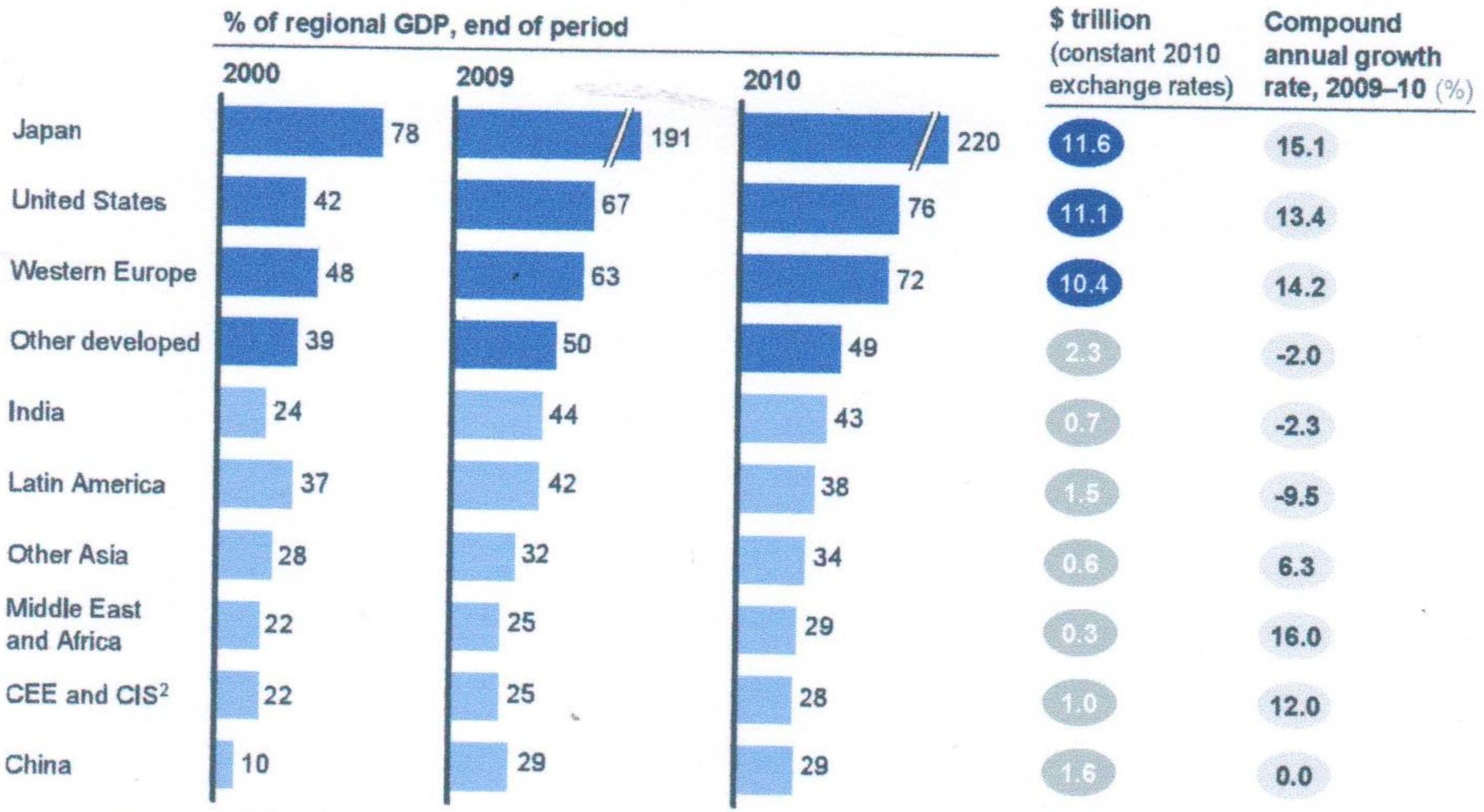
Source: Bank for International Settlements; McKinsey Global Institute analysis

McKinsey&Company

Exhibit 10

Governments in many developed economies have steadily increased public debt over the last ten years

Gross public debt outstanding[1] per region

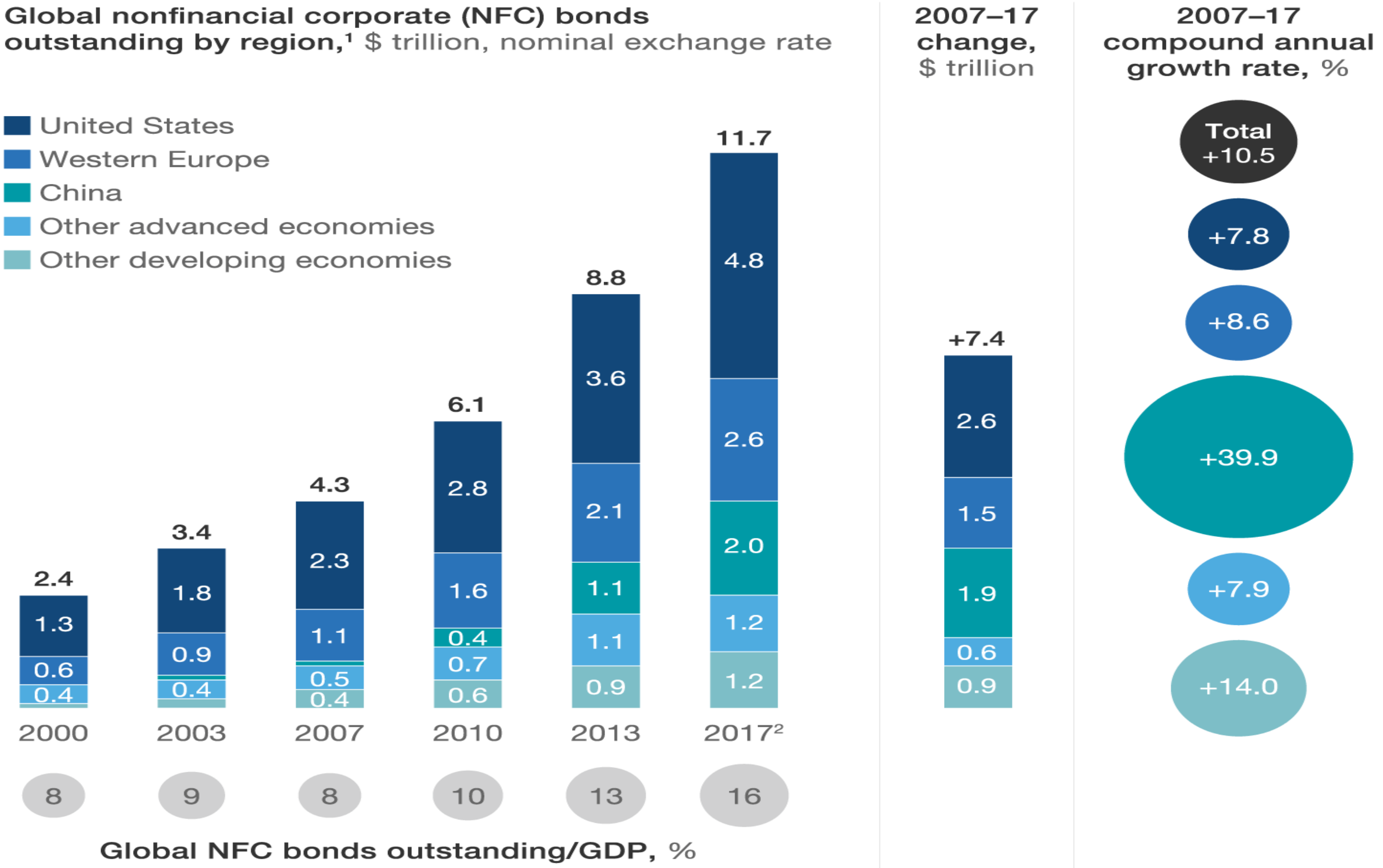


1 Defined as general government marketable debt securities; excludes government debt held by government agencies (e.g., US Social Security Trust Fund).

2 Central and Eastern Europe and Commonwealth of Independent States.

SOURCE: Bank for International Settlements; McKinsey Global Institute analysis

Nonfinancial corporate bonds outstanding have increased 2.7 times over the past decade to $11.7 trillion.



Global nonfinancial corporate (NFC) bonds outstanding by region,[1] $ trillion, nominal exchange rate

2007–17 change, $ trillion

2007–17 compound annual growth rate, %

Global NFC bonds outstanding/GDP, %

Note: Figures may not sum to 100% or totals listed, because of rounding.

[1] Bond nationality is based on the location of the headquarters of the parent company of the company issuing bonds.

[2] Data as of December 4, 2017.

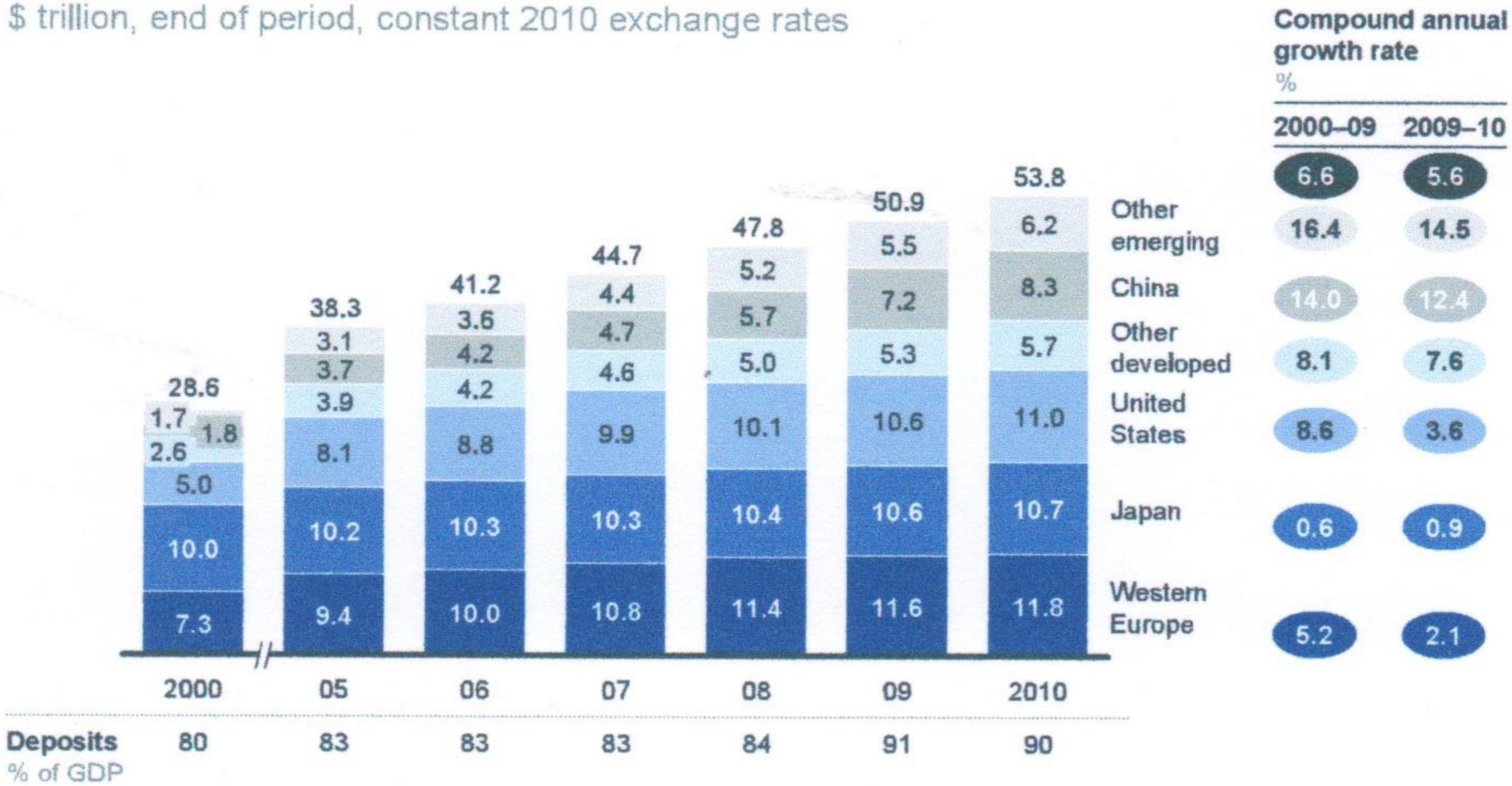
McKinsey&Company | **Source:** Dealogic; McKinsey Global Institute analysis

Exhibit 11

Bank deposits grew by 5.6 percent to total $54 trillion globally by the end of 2010

Global bank deposits[1]

$ trillion, end of period, constant 2010 exchange rates

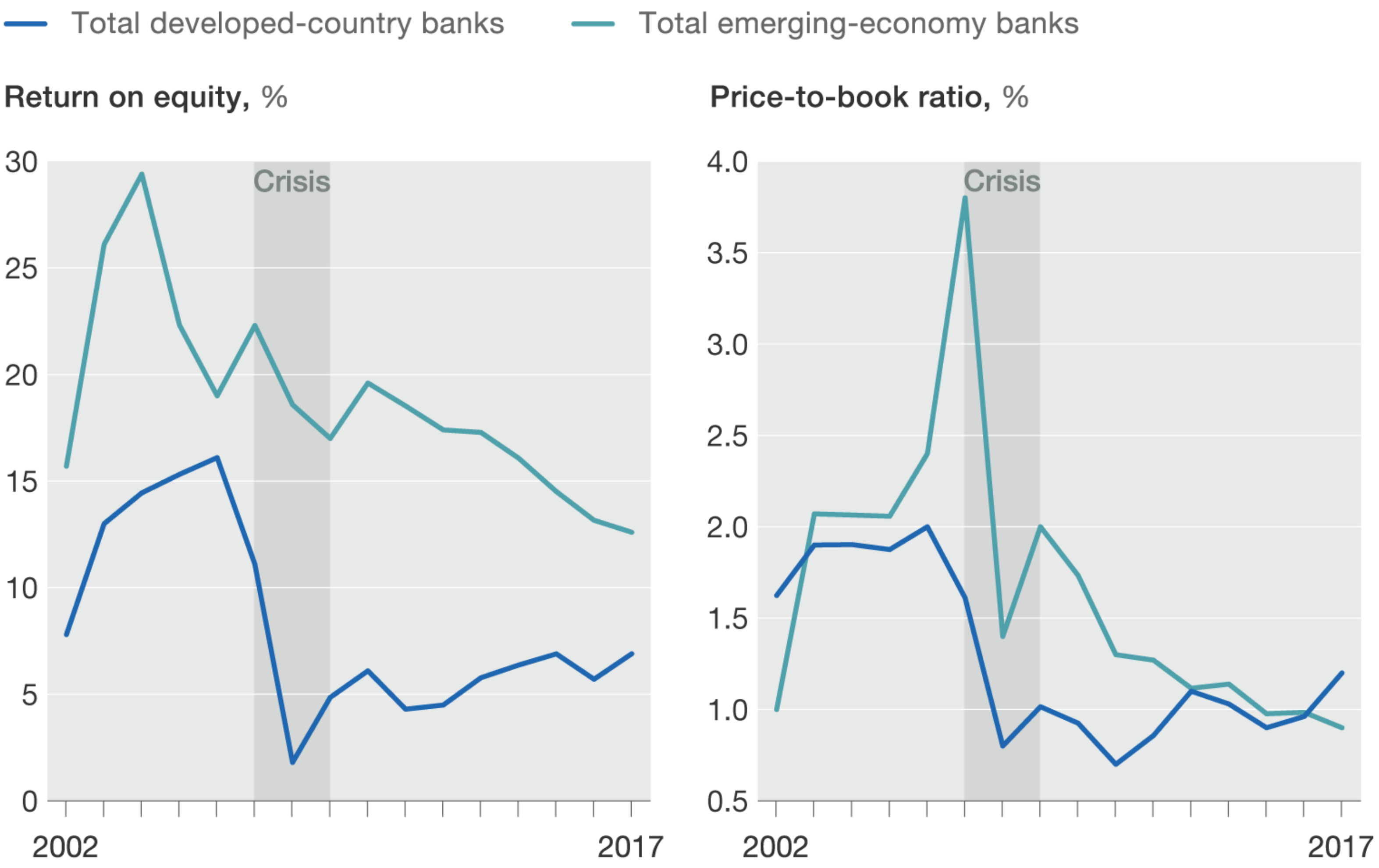


[1] Excludes cash in circulation, money market instruments, and deposits made by nonbank financial institutions with other parts of the banking system.

NOTE: Numbers may not sum due to rounding.

SOURCE: National central banks; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Banks have posted weaker financial performance since the crisis.



Return on equity, %

Price-to-book ratio, %

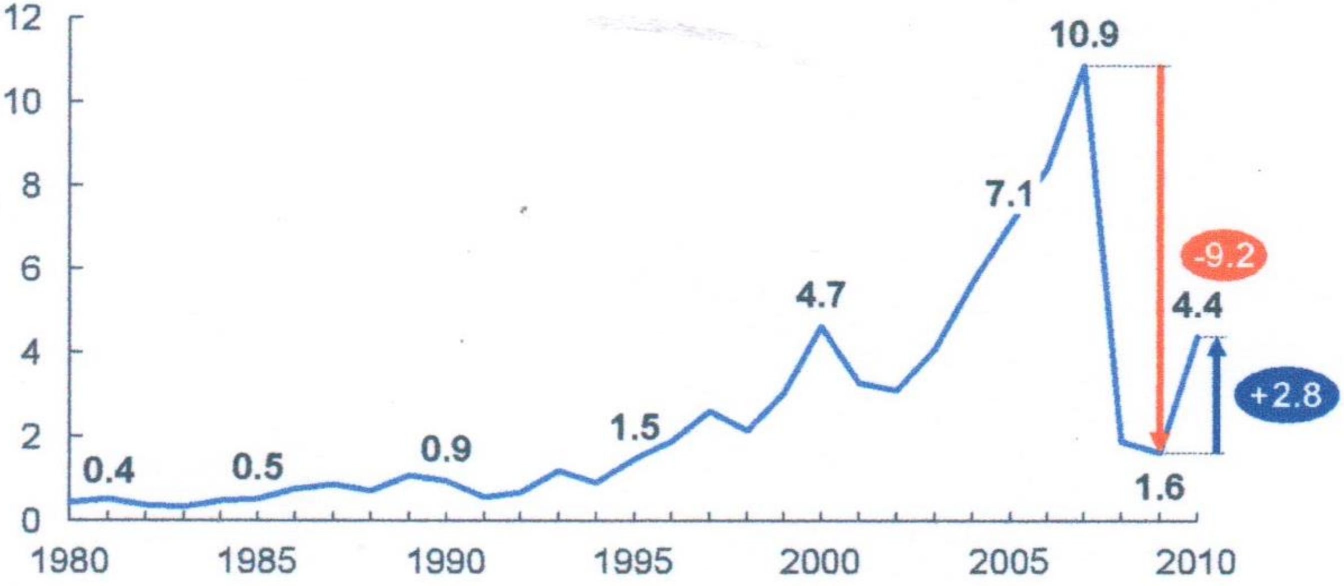
Note: Analysis includes ~1,000 banks in 70 countries, each with total assets exceeding $2 billion. They account for ~75 percent of global bank assets.

McKinsey&Company | **Source:** SNL Banker; Panorama by McKinsey

Exhibit 15

Cross-border capital flows grew to $4.4 trillion in 2010, or 40 percent of their 2007 level

Total cross-border capital inflows, 1980–2010[1,2]
$ trillion, constant 2010 exchange rates



% of global GDP	4	4	5	6	13	15	8

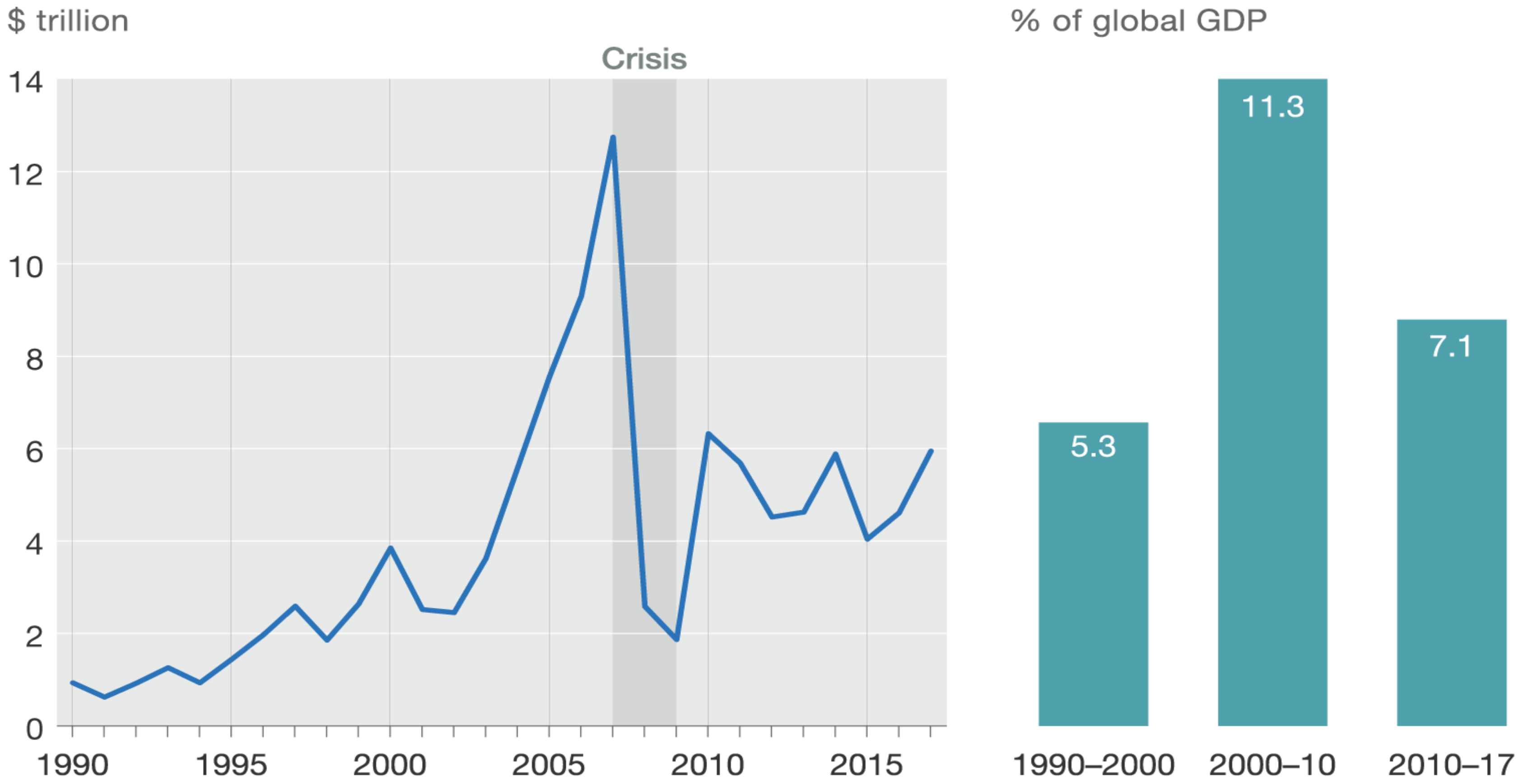
1 "Inflows" defined as net purchases of domestic assets by nonresidents (including nonresident banks); total capital inflows comprised of inward FDI and portfolio (e.g., equity and debt) and lending inflows.

2 Based on a sample of 79 countries.

SOURCE: International Monetary Fund; Institute of International Finance; McKinsey Global Institute analysis

Global cross-border capital flows have declined 53 percent since the 2007 peak.

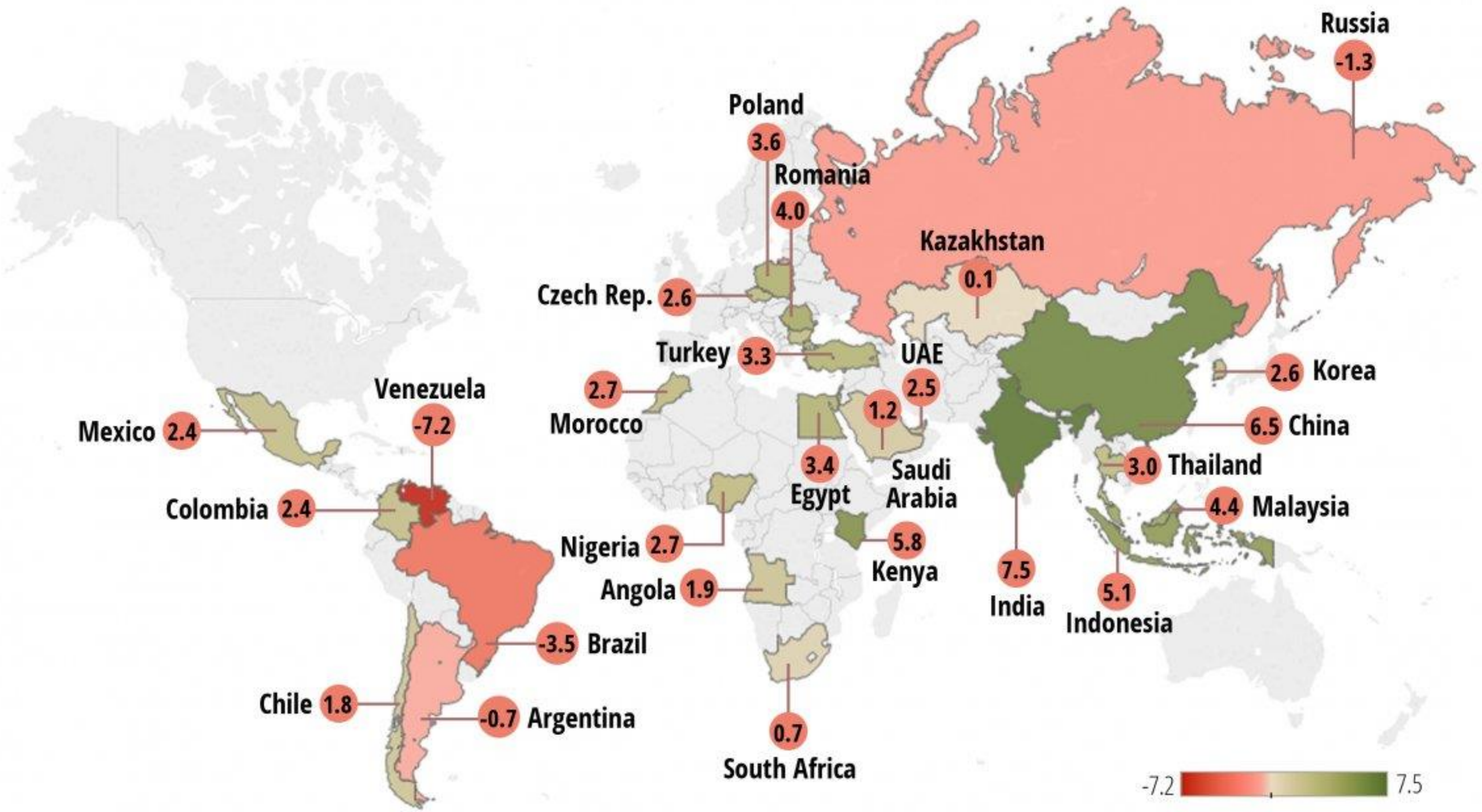
Global cross-border capital flows,[1]



[1] Gross capital inflows, including foreign direct investment, debt securities, equity, lending, and other investment.
Source: IMF balance of payments statistics; McKinsey Global Institute analysis

EMERGING MARKETS OUTLOOK 2016

GDP growth rates of emerging economies this year are projected to be no higher than in 2015



FOCUSECONOMICS

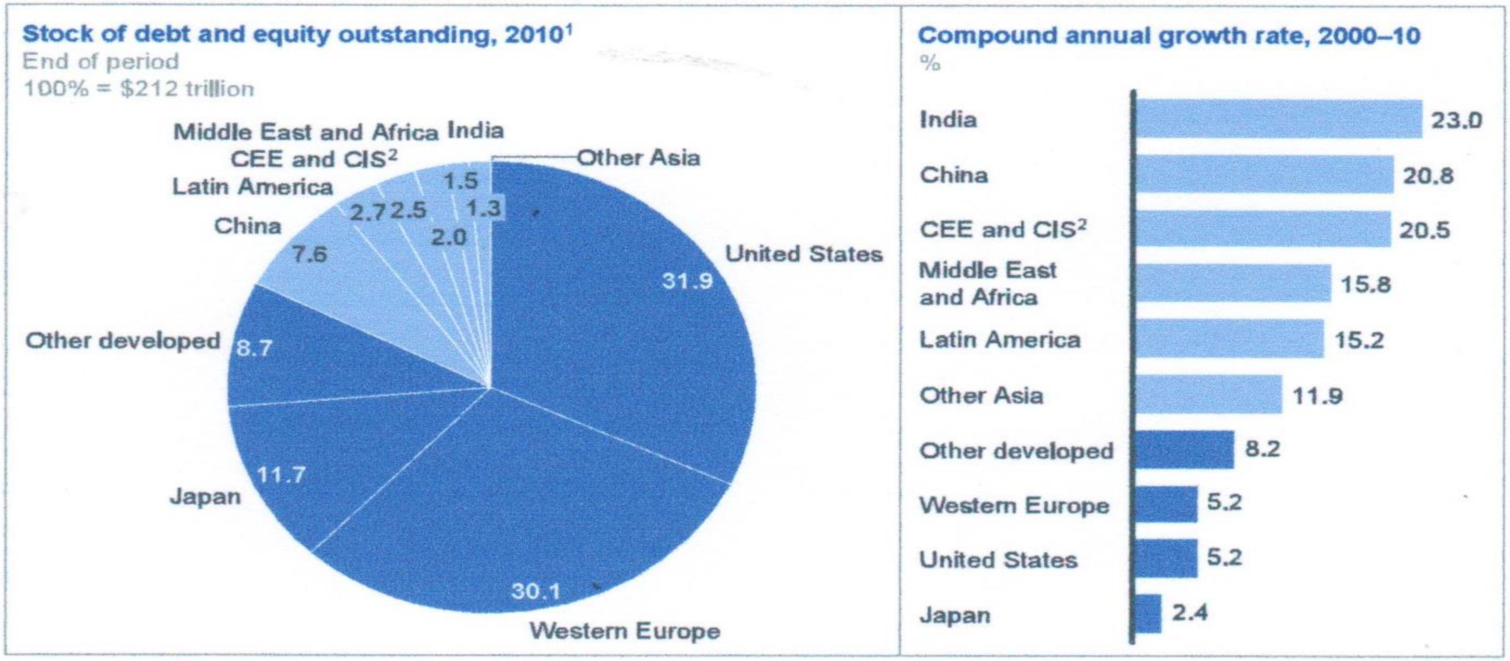
Emerging markets account for 18 percent of the global financial stock, but their share has tripled since 2000

Exhibit 12

Emerging markets account for the smallest share but also the fastest growth in the global financial stock

Stock of debt and equity outstanding, 2010[1]
% of total, end of period

■ Developed countries
□ Emerging markets



Stock of debt and equity outstanding, 2010[1]
End of period
100% = $212 trillion

Compound annual growth rate, 2000–10
%

[1] Based on a sample of 79 countries.
[2] Central and Eastern Europe and Commonwealth of Independent States.

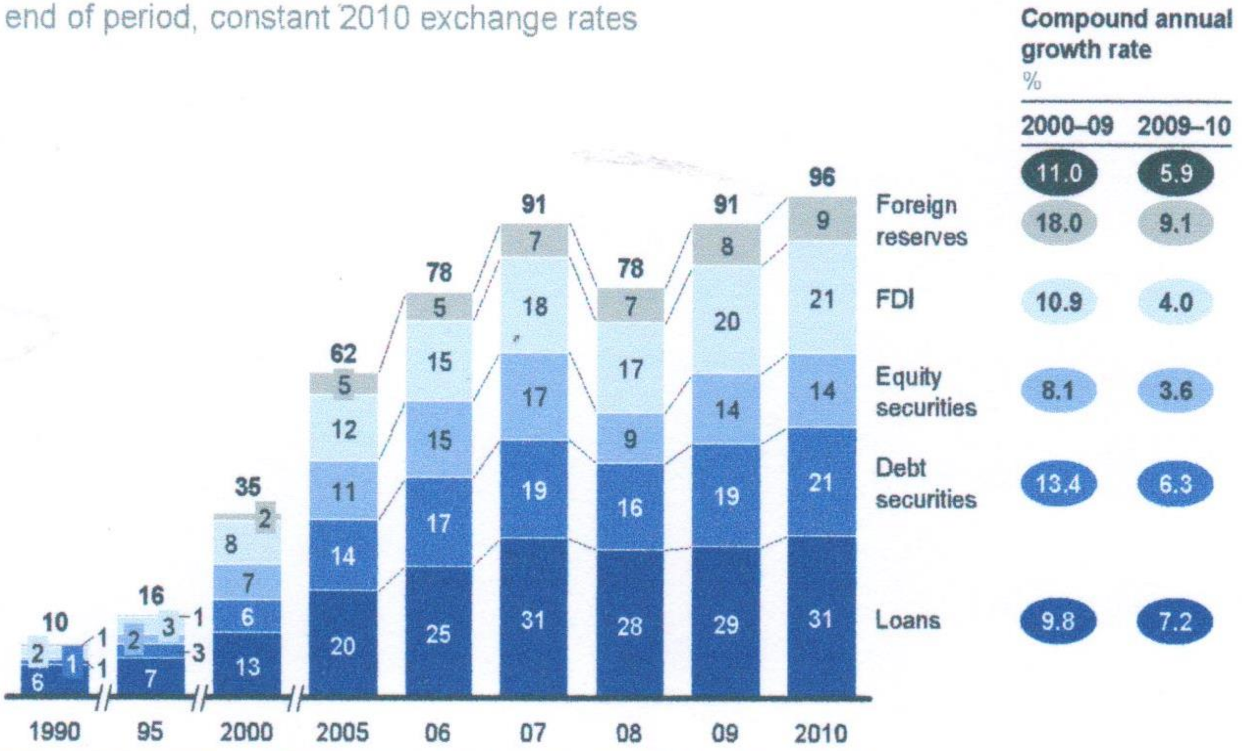
SOURCE: Bank for International Settlements; Dealogic; SIFMA; S&P; McKinsey Global Banking Pools; McKinsey Global Institute analysis

Exhibit 19

The stock of global foreign investment assets reached $96 trillion in 2010

Global foreign investment assets (FIA)[1]

$ trillion, end of period, constant 2010 exchange rates



Global FIA % of global GDP	55	66	107	134	156	170	138	162	161

1 Based on a sample of 79 countries.

NOTE: Numbers may not sum due to rounding.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

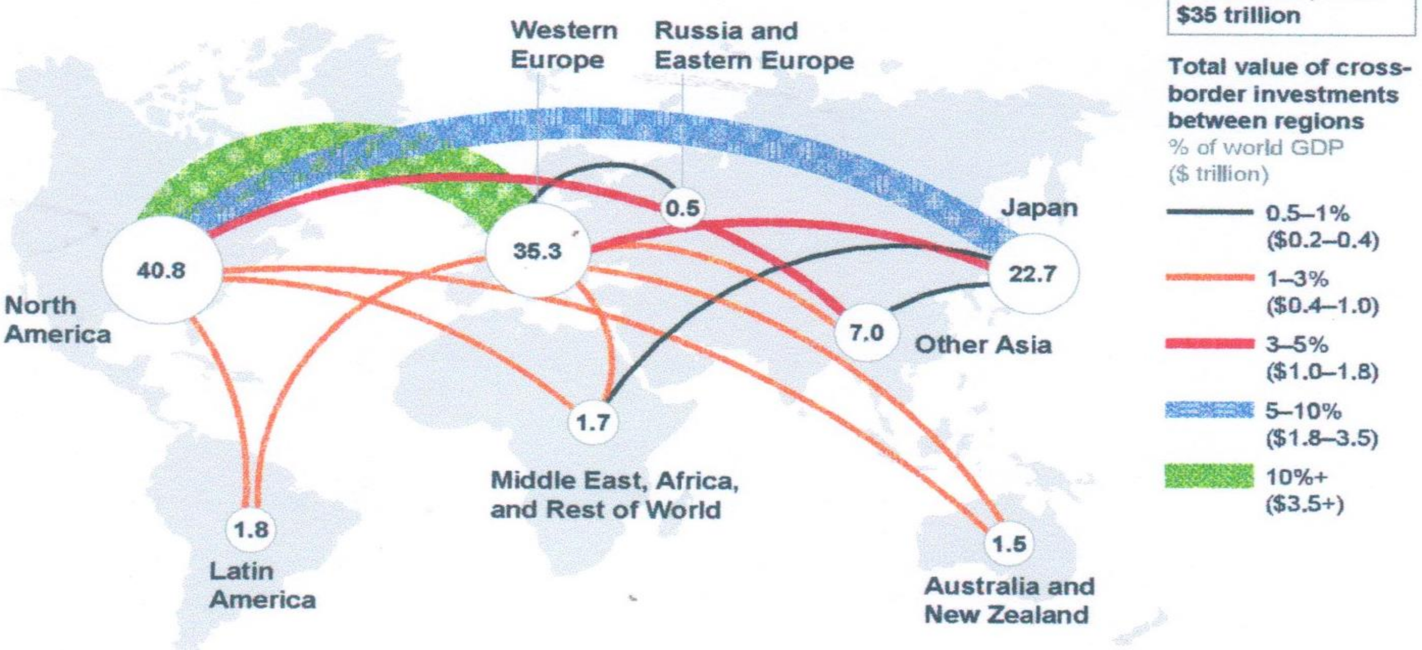
The global web of cross-border investments in 1999 centered on the United States and Western Europe

Exhibit 20a

In 1999, cross-border investing was taking hold

Figures inside bubbles are regional financial stock

Lines between regions show total cross-border investments[1]



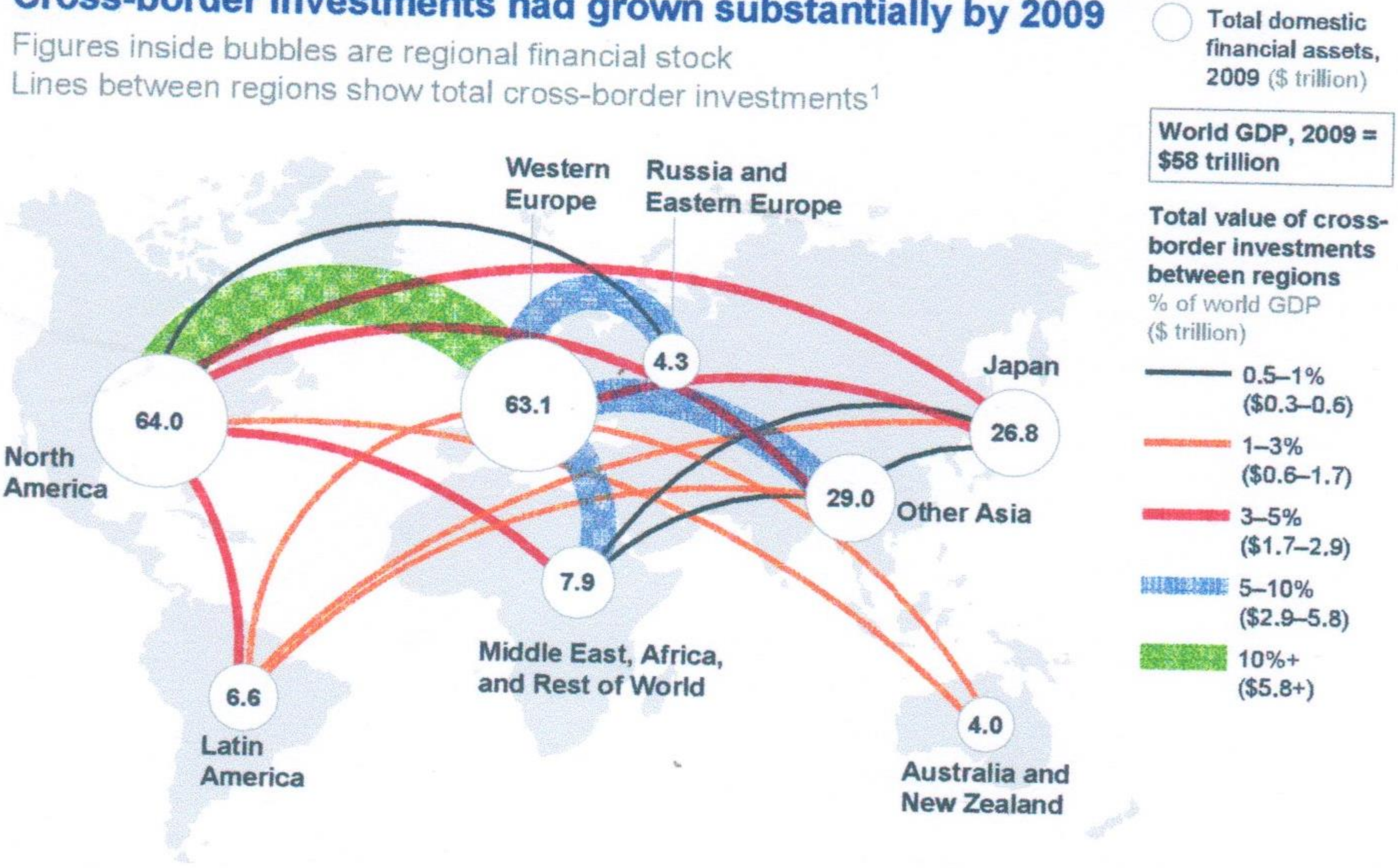
[1] Includes total value of cross-border investments in equity and debt securities, loans and deposits, and foreign direct investment.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

Exhibit 20b

Cross-border investments had grown substantially by 2009

Figures inside bubbles are regional financial stock
Lines between regions show total cross-border investments[1]



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[1] Includes total value of cross-border investments in equity and debt securities, loans and deposits, and foreign direct investment.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

The global web of cross-border investments in 1999 centered on the United States and Western Europe

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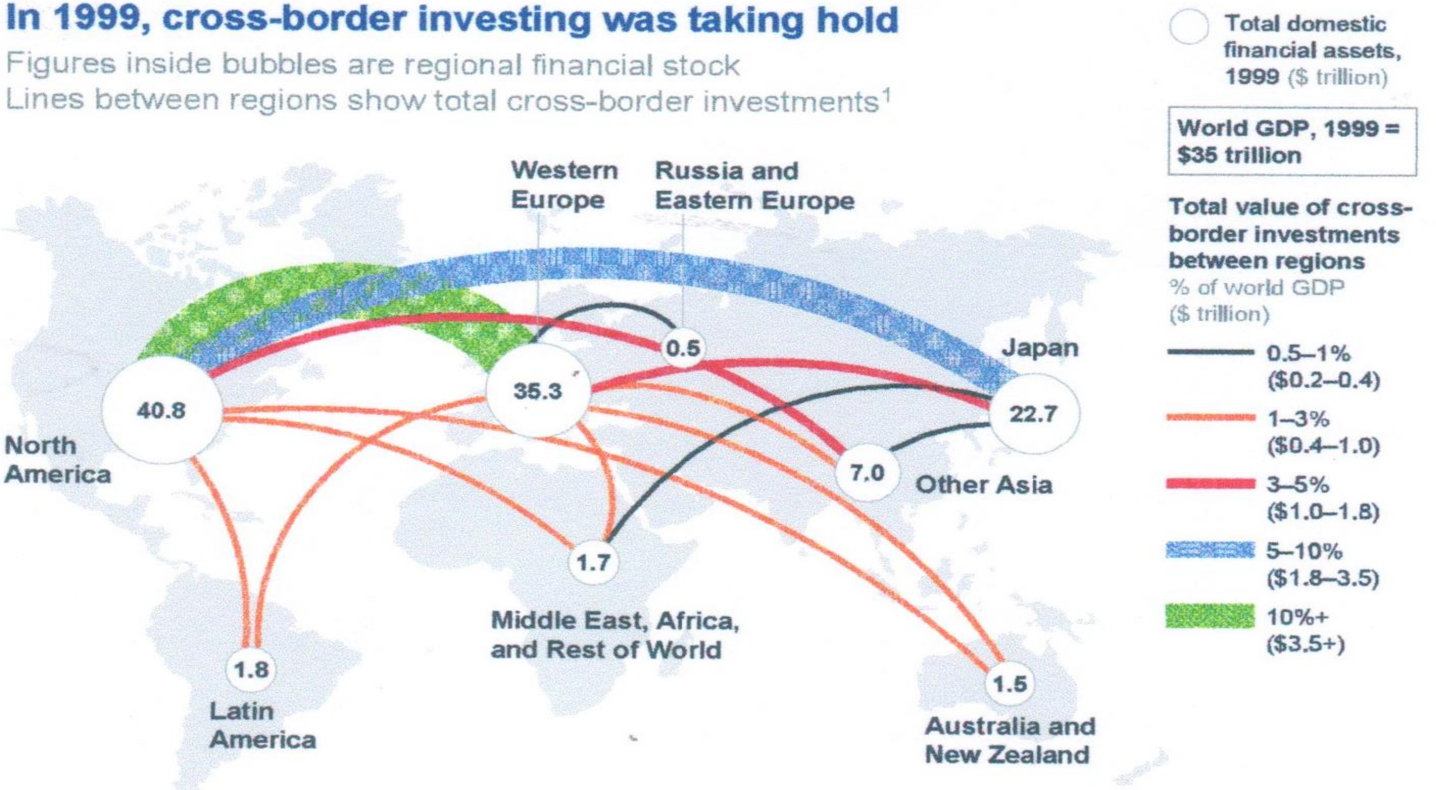
Exhibit 20a

In 1999, cross-border investing was taking hold

Figures inside bubbles are regional financial stock

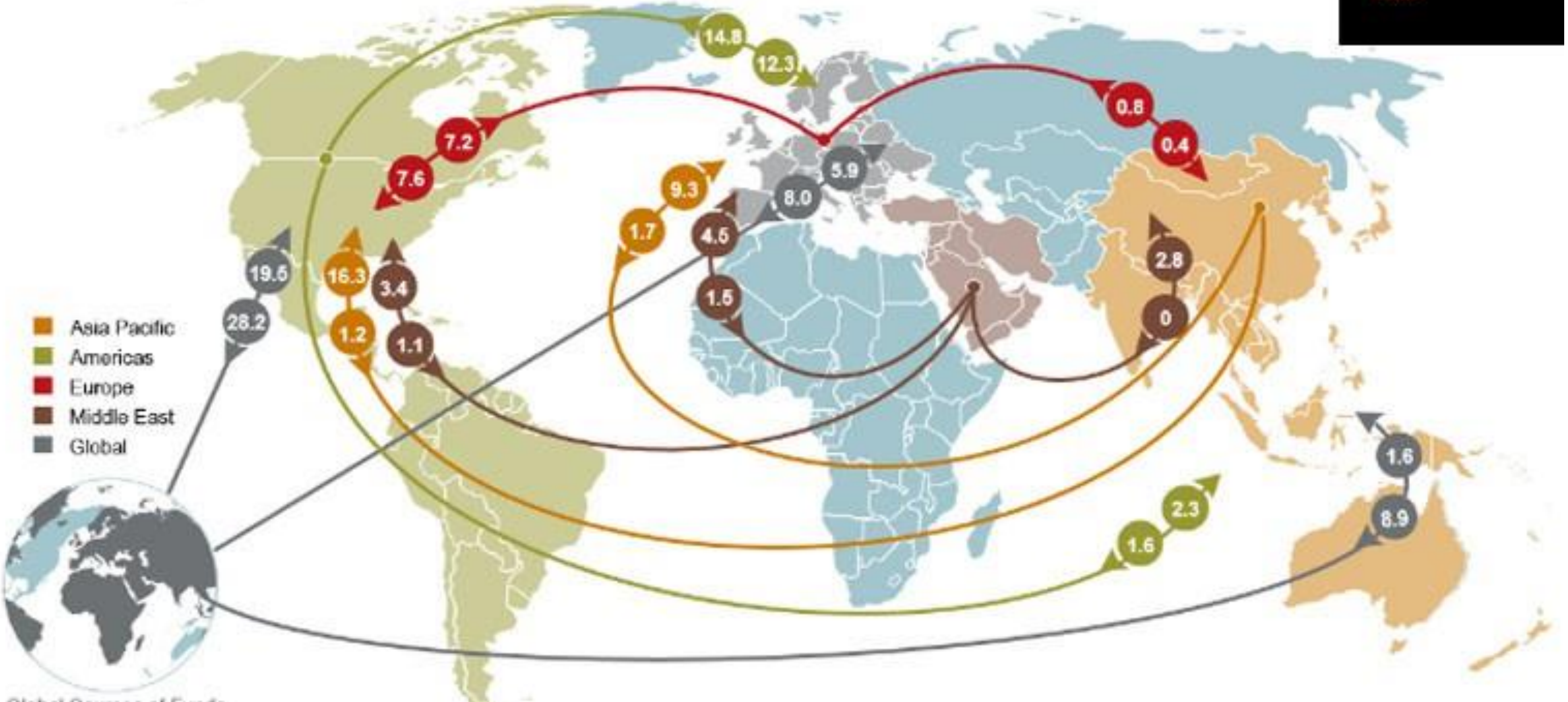
Lines between regions show total cross-border investments[1]



[1] Includes total value of cross-border investments in equity and debt securities, loans and deposits, and foreign direct investment.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

Inter-Regional Flows, YTD 2016 (US$136 billion in total)



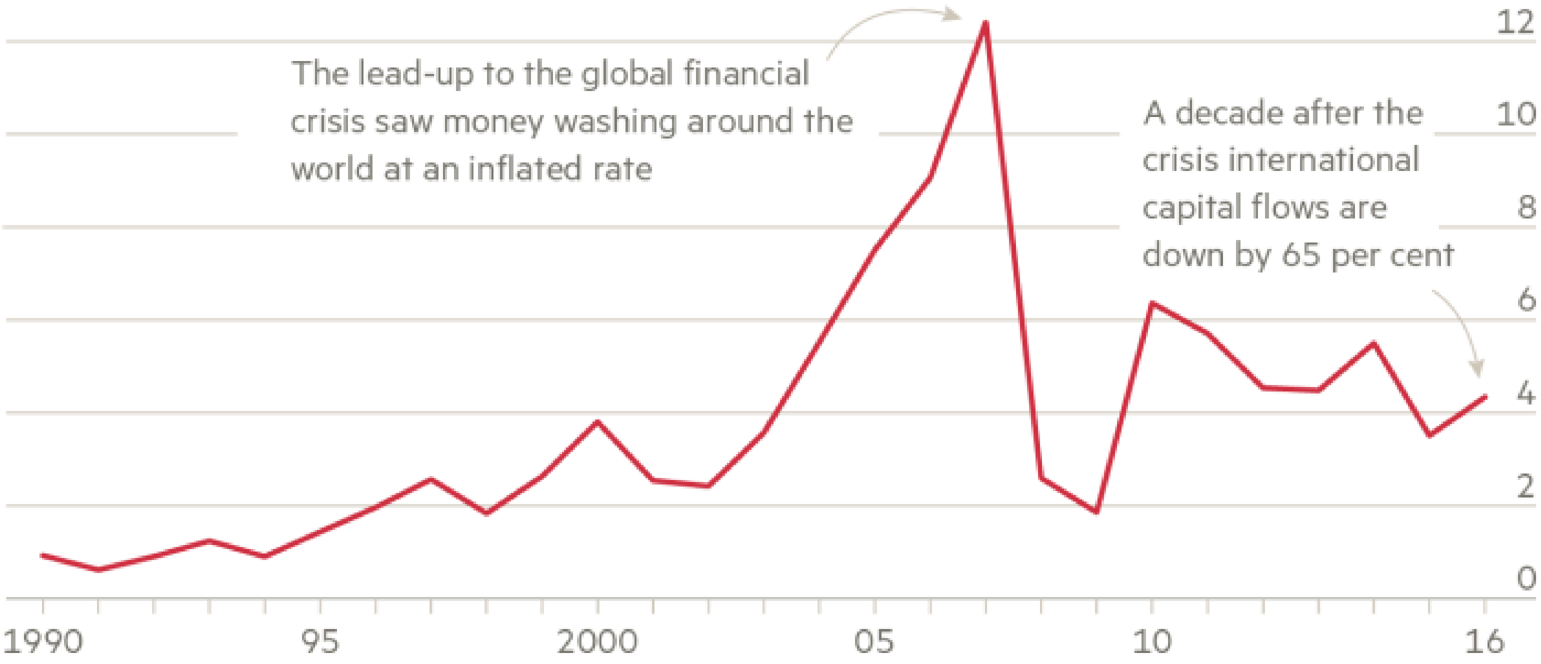
Global Sources of Funds

Global groups that raise capital from multiple regions, with less than 70% of the capital from a particular country

Deglobalization?

Global cross-border capital inflows have declined since the 2007 peak

($tn)

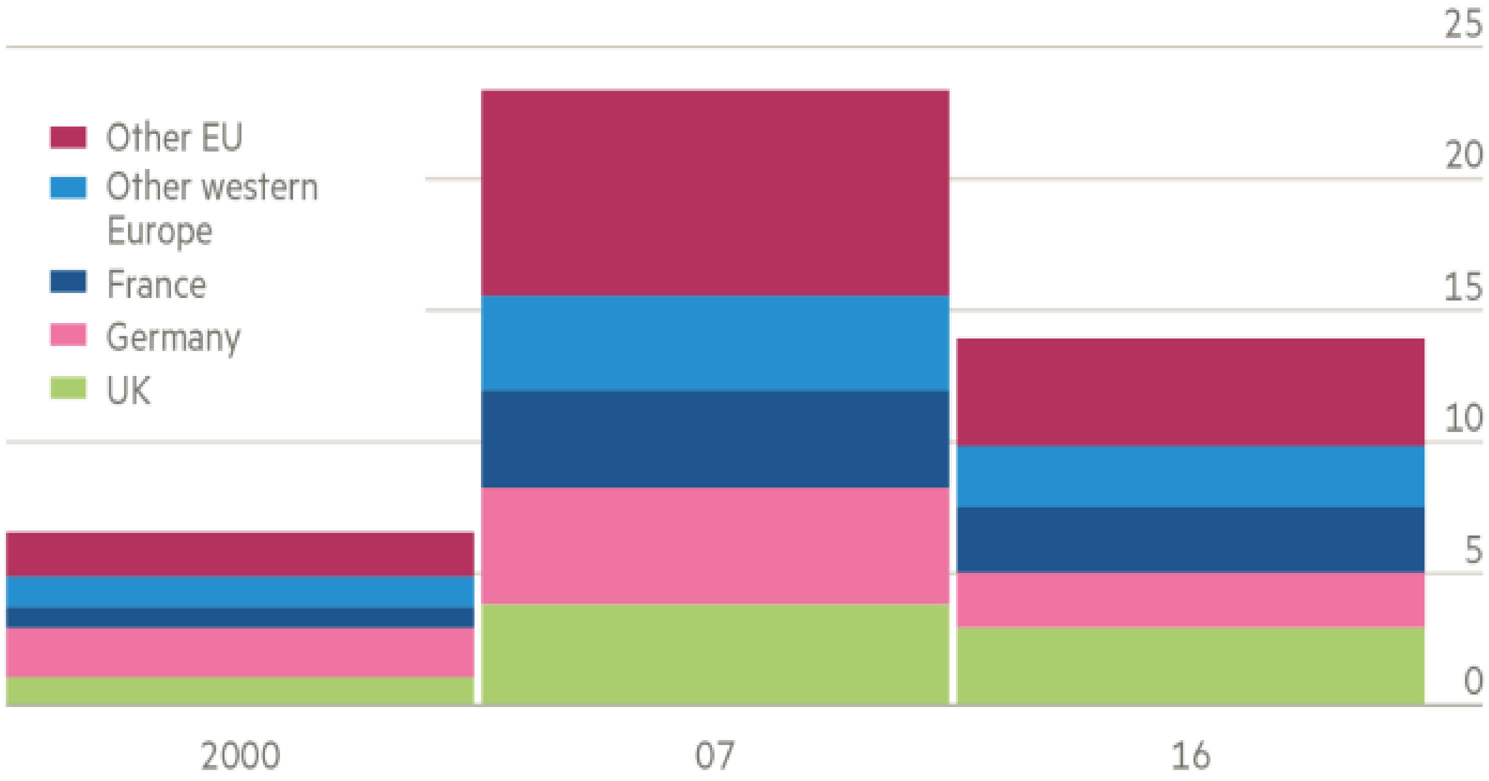


The lead-up to the global financial crisis saw money washing around the world at an inflated rate

A decade after the crisis international capital flows are down by 65 per cent

Source: McKinsey

The role of the banks in this trend



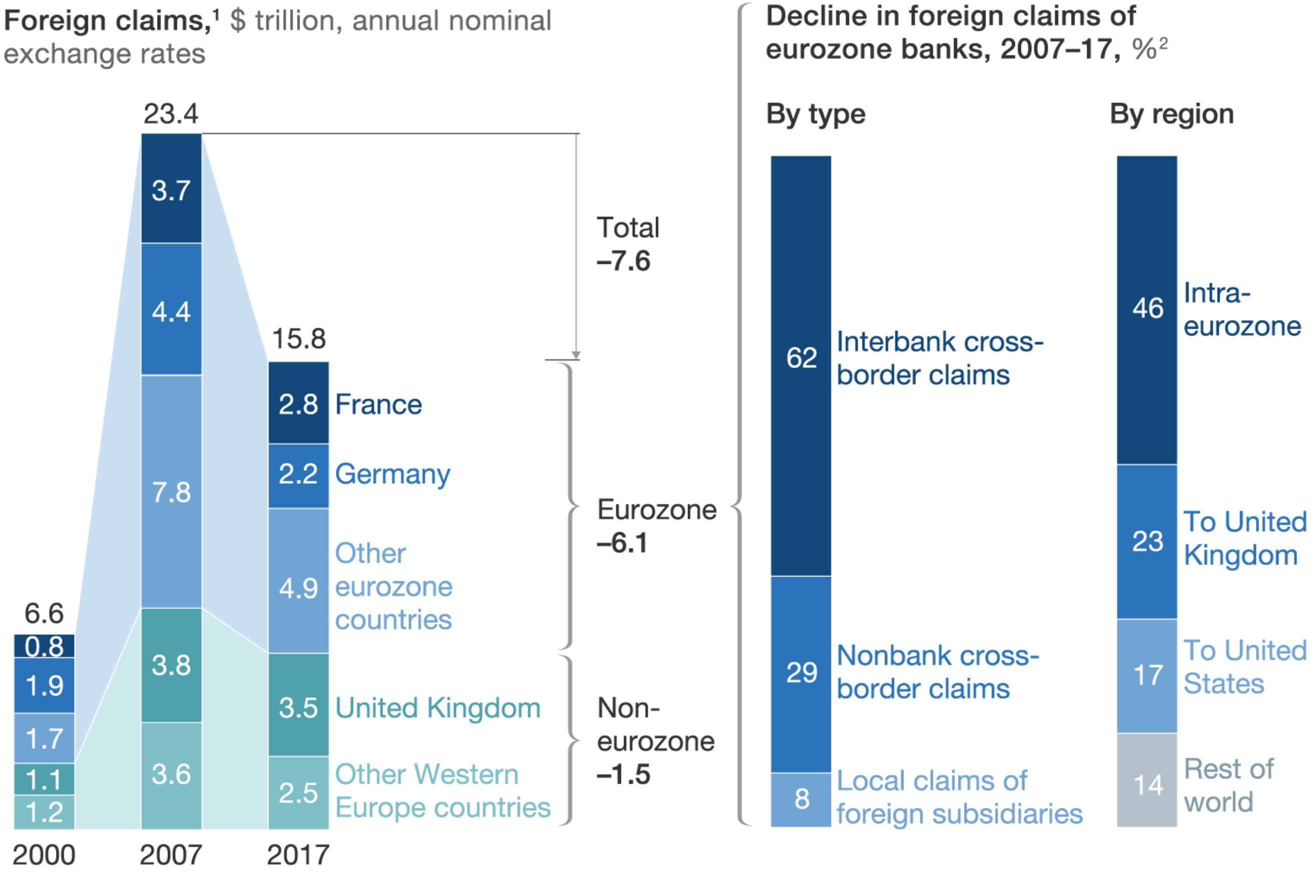
European banks are leading the retreat

Foreign claims $tn, annual nominal exchange rates at 2016 prices

Source: McKinsey

© FT

European banks have reduced foreign claims.



Note: Numbers may not sum to totals listed, because of rounding.

[1] Foreign claims include cross-border claims and local claims of foreign affiliates. Claims include loans, deposits, securities, derivatives, guarantees, and credit commitments.

[2] 100% = $6.1 trillion.

Source: Bank for International Settlements; McKinsey Global Institute analysis

McKinsey&Company

Investors from developed countries hold 87 percent of global foreign investment assets

Exhibit 21

In 2010, the United States was the world's largest foreign debtor and Japan the globe's largest foreign creditor

Net position, 2010[1]

$ billion

Largest net foreign debtors[1]

		Assets	Liabilities
United States	-3,072	15,284	18,356
Spain	-1,263	1,673	2,936
Australia	-752	1,044	1,796
Brazil	-703	587	1,290
Italy	-453	2,734	3,187
United Kingdom	-446	10,943	11,390
Mexico	-355	259	613
Greece	-331	315	646
France	-325	6,622	6,947
Poland	-308	162	470

Largest net foreign creditors[1]

		Assets	Liabilities
Japan	3,010	6,759	3,748
China	2,193	3,892	1,699
Germany	1,207	7,323	6,116
Saudi Arabia	882	1,084	202
Switzerland	698	3,047	2,348
Hong Kong	691	2,723	2,032
Taiwan	626	1,015	389
United Arab Emirates	585	783	198
Singapore	492	1,376	884
Norway	360	1,122	762

[1] Calculated as foreign investment assets less foreign investment liabilities.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

Table 19: Amounts outstanding of over-the-counter (OTC) derivatives

By risk category and instrument

In billions of US dollars

	Notional amounts outstanding					Gross market values				
Risk Category / Instrument	**Dec 2009**	**Jun 2010**	**Dec 2010**	**Jun 2011**	**Dec 2011**	**Dec 2009**	**Jun 2010**	**Dec 2010**	**Jun 2011**	**Dec 2011**
Total contracts	**603,900**	**582,685**	**601,046**	**706,884**	**647,762**	**21,542**	**24,697**	**21,296**	**19,518**	**27,285**
Foreign exchange contracts	**49,181**	**53,153**	**57,796**	**64,698**	**63,349**	**2,070**	**2,544**	**2,482**	**2,336**	**2,555**
Forwards and forex swaps	23,129	25,624	28,433	31,113	30,526	683	930	886	777	919
Currency swaps	16,509	16,360	19,271	22,228	22,791	1,043	1,201	1,235	1,227	1,318
Options	9,543	11,170	10,092	11,358	10,032	344	413	362	332	318
Interest rate contracts	**449,875**	**451,831**	**465,260**	**553,240**	**504,098**	**14,020**	**17,533**	**14,746**	**13,244**	**20,001**
Forward rate agreements	51,779	56,242	51,587	55,747	50,576	80	81	206	59	67
Interest rate swaps	349,288	347,508	364,377	441,201	402,611	12,576	15,951	13,139	11,861	18,046
Options	48,808	48,081	49,295	56,291	50,911	1,364	1,501	1,401	1,324	1,888
Equity-linked contracts	**5,937**	**6,260**	**5,635**	**6,841**	**5,982**	**708**	**706**	**648**	**708**	**679**
Forwards and swaps	1,652	1,754	1,828	2,029	1,738	176	189	167	176	156
Options	4,285	4,506	3,807	4,813	4,244	532	518	480	532	523
Commodity contracts	**2,944**	**2,852**	**2,922**	**3,197**	**3,091**	**545**	**458**	**526**	**471**	**487**
Gold	423	417	397	468	521	48	45	47	50	82
Other commodities	2,521	2,434	2,525	2,729	2,570	497	413	479	421	405
Forwards and swaps	1,675	1,551	1,781	1,846	1,745					
Options	846	883	744	883	824					
Credit default swaps	**32,693**	**30,261**	**29,898**	**32,409**	**28,633**	**1,801**	**1,666**	**1,351**	**1,345**	**1,586**
Single-name instruments	21,917	18,494	18,145	18,105	16,881	1,243	993	884	854	962
Multi-name instruments	10,776	11,767	11,753	14,305	11,752	558	673	466	490	624
of which index products	...	7,500	7,476	12,473	10,466					
Unallocated	**63,270**	**38,329**	**39,536**	**46,498**	**42,609**	**2,398**	**1,789**	**1,543**	**1,414**	**1,977**
Memorandum Item:										
Gross Credit Exposure						3,521	3,581	3,480	2,971	3,912

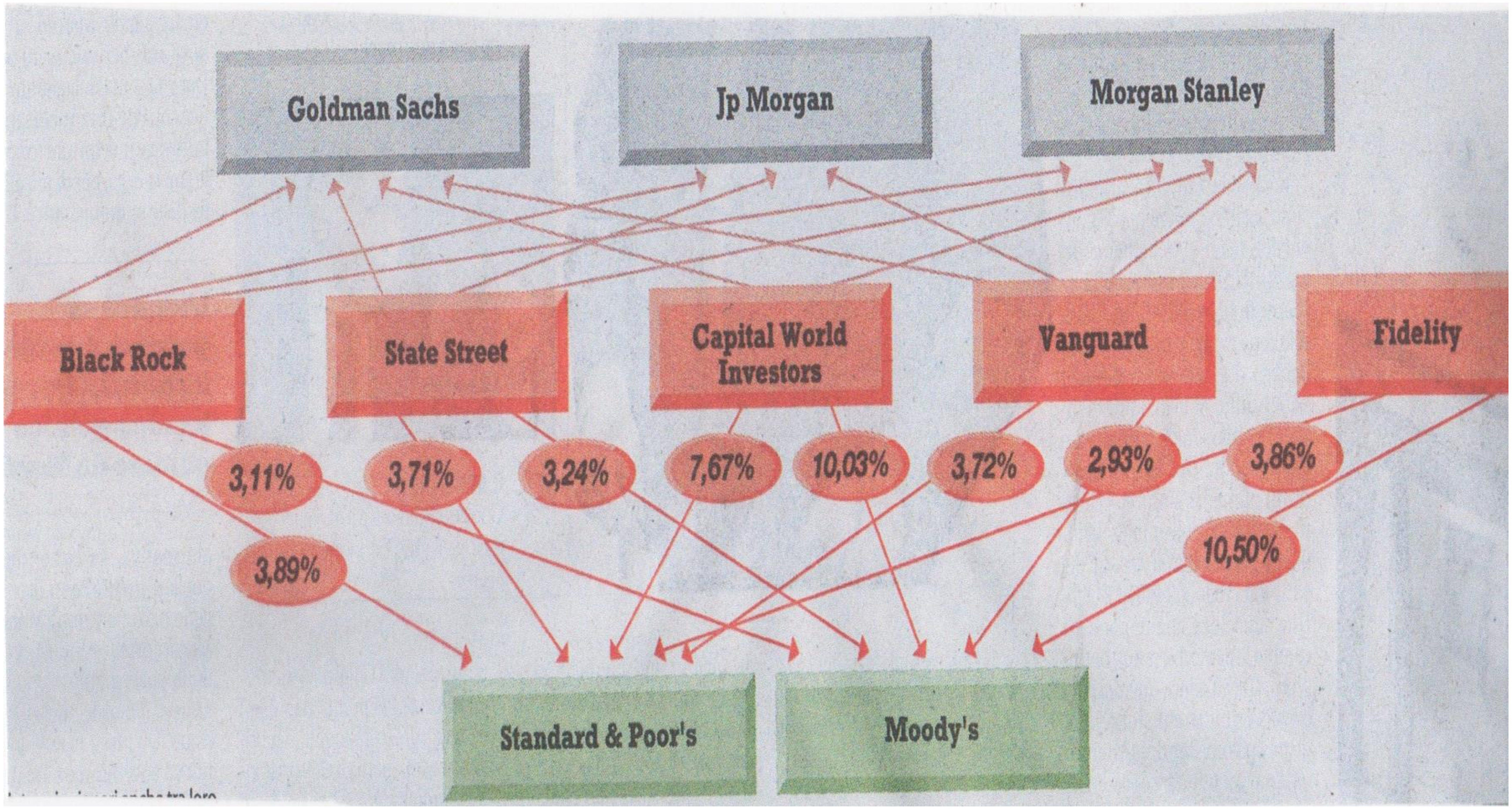
Table 20A: Amounts outstanding of OTC foreign exchange derivatives

By instrument and counterparty

In billions of US dollars

	Notional amounts outstanding					Gross market values				
Instrument / counterparty	**Dec 2009**	**Jun 2010**	**Dec 2010**	**Jun 2011**	**Dec 2011**	**Dec 2009**	**Jun 2010**	**Dec 2010**	**Jun 2011**	**Dec 2011**
Total contracts	**49,181**	**53,153**	**57,796**	**64,698**	**63,349**	**2,070**	**2,544**	**2,482**	**2,336**	**2,555**
Reporting dealers	18,896	19,924	21,956	26,170	27,953	732	890	899	875	1,041
Other financial institutions	21,445	23,476	25,636	28,854	25,916	888	1,100	1,050	973	989
Non-financial customers	8,840	9,753	10,204	9,675	9,480	449	554	534	489	525
Outright forwards and foreign exchange swaps	**23,129**	**25,624**	**28,433**	**31,113**	**30,526**	**683**	**930**	**886**	**777**	**919**
Reporting dealers	7,683	8,370	9,262	10,932	11,319	235	315	326	318	351
Other financial institutions	10,497	11,878	13,018	14,529	13,386	300	400	365	302	385
Non-financial customers	4,949	5,376	6,153	5,651	5,820	148	215	194	157	183
Currency swaps	**16,509**	**16,360**	**19,271**	**22,228**	**22,791**	**1,043**	**1,201**	**1,235**	**1,227**	**1,318**
Reporting dealers	7,112	7,027	8,320	10,075	11,819	332	388	390	387	520
Other financial institutions	7,282	7,274	8,802	9,749	8,613	478	561	586	576	518
Non-financial customers	2,115	2,059	2,149	2,404	2,359	233	252	258	264	280
Options	**9,543**	**11,170**	**10,092**	**11,358**	**10,032**	**344**	**413**	**362**	**332**	**318**
Reporting dealers	4,101	4,528	4,373	5,163	4,815	166	186	182	170	170
Other financial institutions	3,666	4,324	3,816	4,575	3,917	111	139	98	95	86
Non-financial customers	1,775	2,318	1,902	1,619	1,301	68	88	81	67	62

Working in the interest of the markets or just another conflict of interest ?



- "The three credit rating agencies were key enablers of the financial meltdown. The mortgage-related securities at the heart of the crisis could not have been marketed and sold without their seal of approval. Investors relied on them, often blindly. In some cases, they were obligated to use them, or regulatory capital standards were hinged on them. This crisis could not have happened without the rating agencies. Their ratings helped the market soar and their downgrades through 2007 and 2008 wreaked havoc across markets and firms."
- Financial Crisis Inquiry Commission , January 2011