Cass Business School
CITY UNIVERSITY LONDON
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The Costas Grammenos Center for Shipping, Trade & Finance

Seventh City of London Biennial Meeting 2013

Looking Ahead with Optimism and Realism

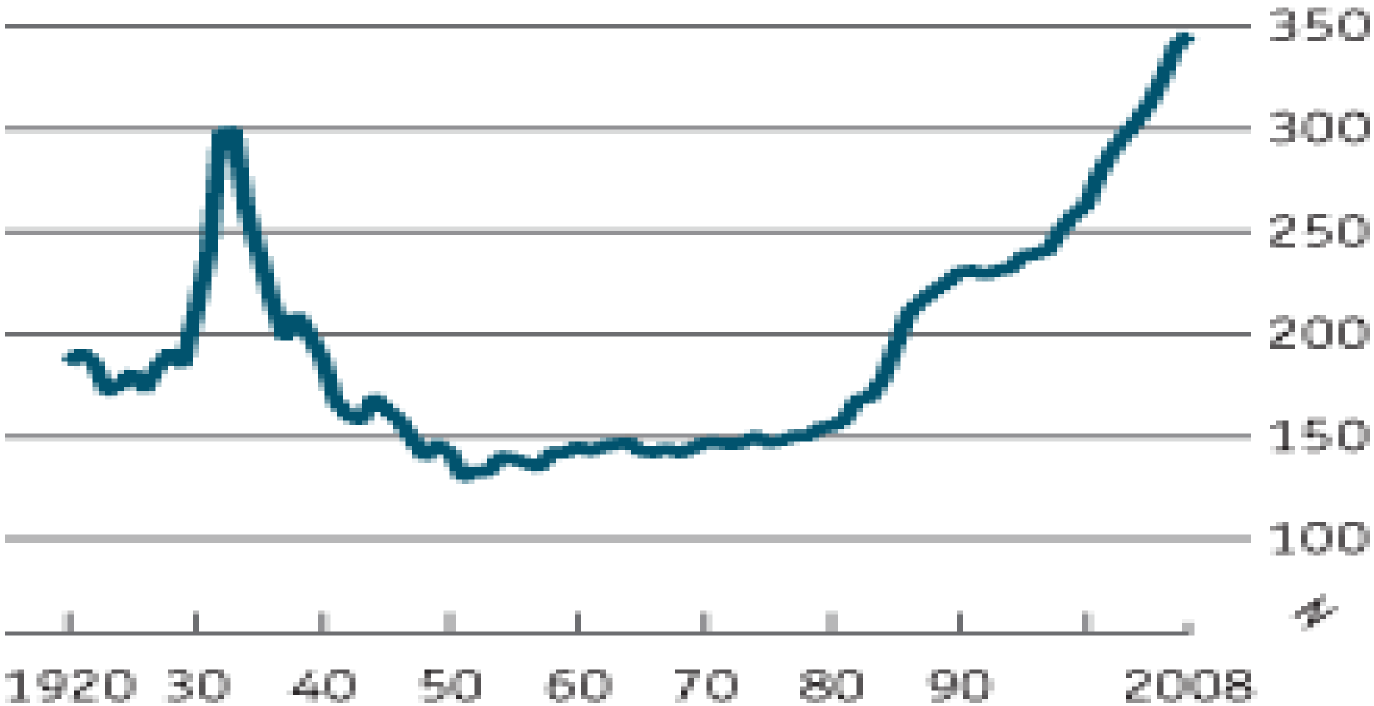
Steve Thomas

Big Finance in a Deleveraging World

- The growth of credit-the interplay of Macroeconomics,Politics,and Bank Regulation…..
- Too much finance?.......deleveraging….
- Uncharted territory-what do we really know?....

In hock

US total debt as % of GDP



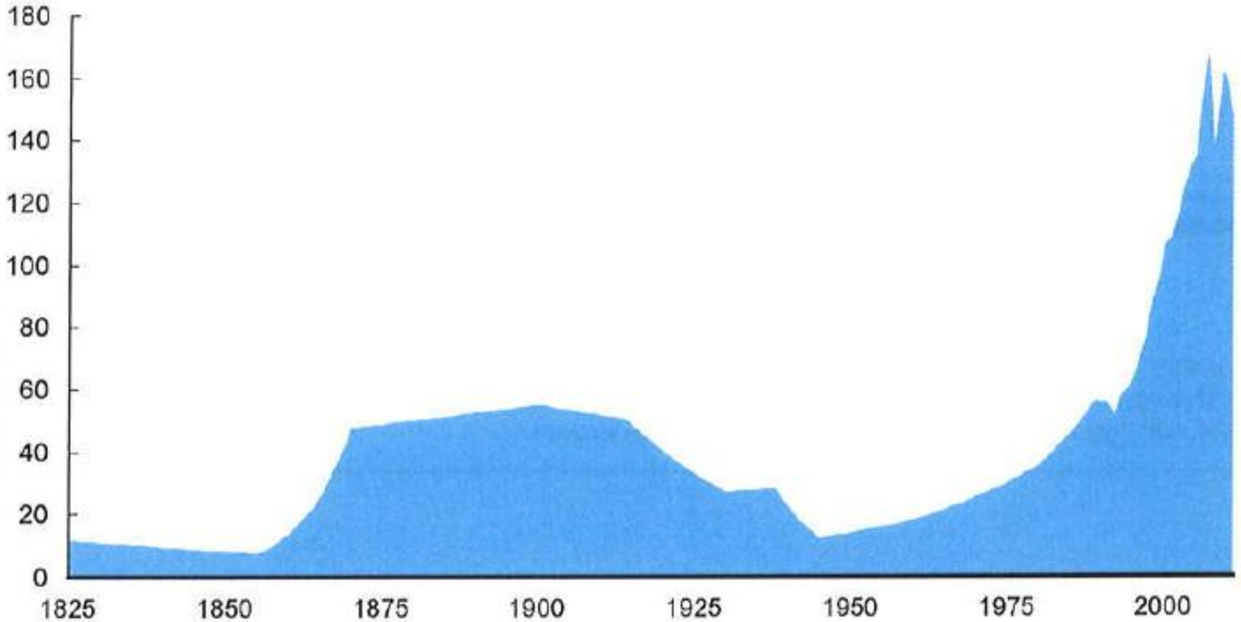
Sources: Morgan Stanley; Federal Reserve; BEA

Exhibit 12

Two eras of financial globalization

Global foreign investment assets

% country sample GDP[1]



1 From 1825 to 1938, our country sample includes Canada, France, Germany, Japan, Netherlands, the United States, the United Kingdom, and other European countries. The sample expands as data becomes available. By 1990, the number of countries increases to 79.

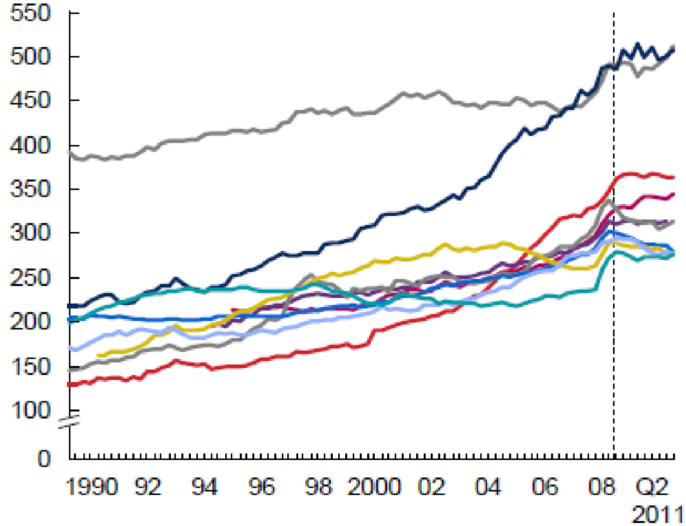
SOURCE: IMF Balance of Payments; Federal Reserve Flow of Funds; US Treasury; Obstfeld and Taylor (2004); McKinsey Global Institute analysis

Exhibit 1

Deleveraging has only just begun in the ten largest developed economies

Total debt,[1] 1990–Q2 2011
% of GDP

▲ Significant increase in leverage[2]
▼ Deleveraging



Change
Percentage points

	2000–08	2008–Q2 2011[3]	
Japan	37	39	▲
United Kingdom	177	20	
Spain	145	26	▲
France	89	35	▲
Italy	68	12	
South Korea	91	-16	▼
United States	75	-16	▼
Germany	7	1	
Australia	77	-14	▼
Canada	39	17	

1 Includes all loans and fixed-income securities of households, corporations, financial institutions, and government.
2 Defined as an increase of 25 percentage points or more.
3 Or latest available.

SOURCE: Haver Analytics; national central banks; McKinsey Global Institute

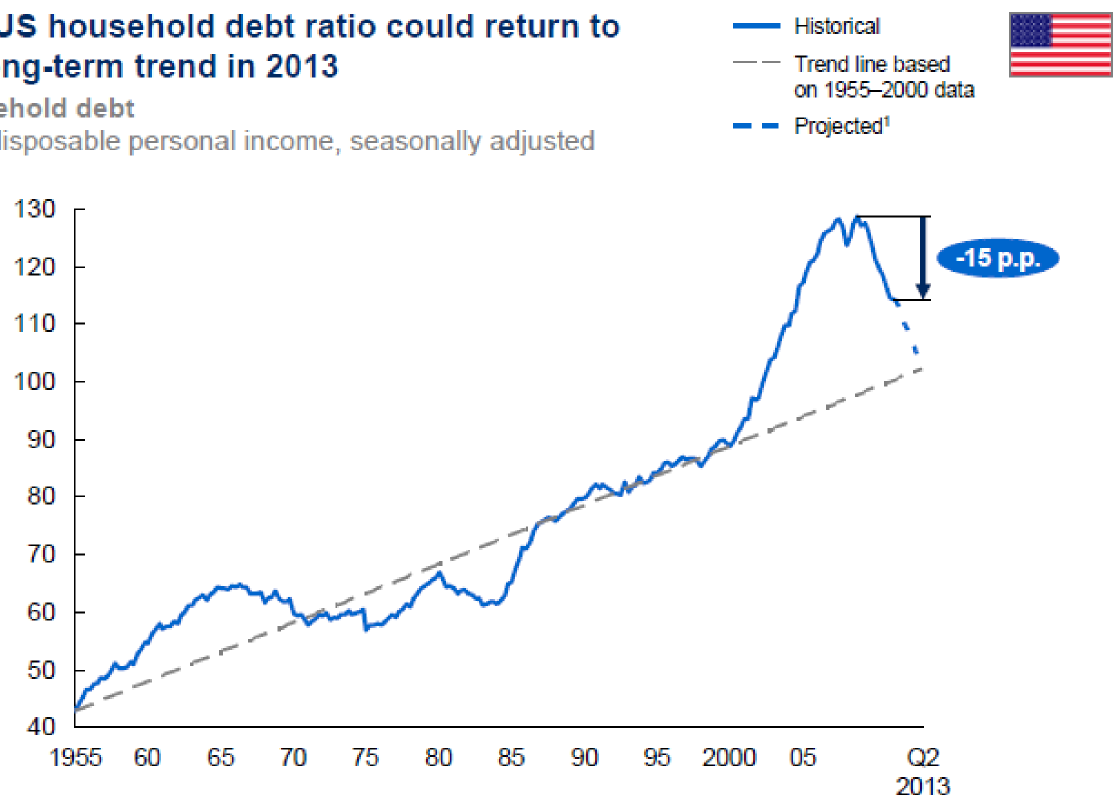
What will be ‘normal’?Does it matter?

Exhibit 7

The US household debt ratio could return to its long-term trend in 2013

Household debt

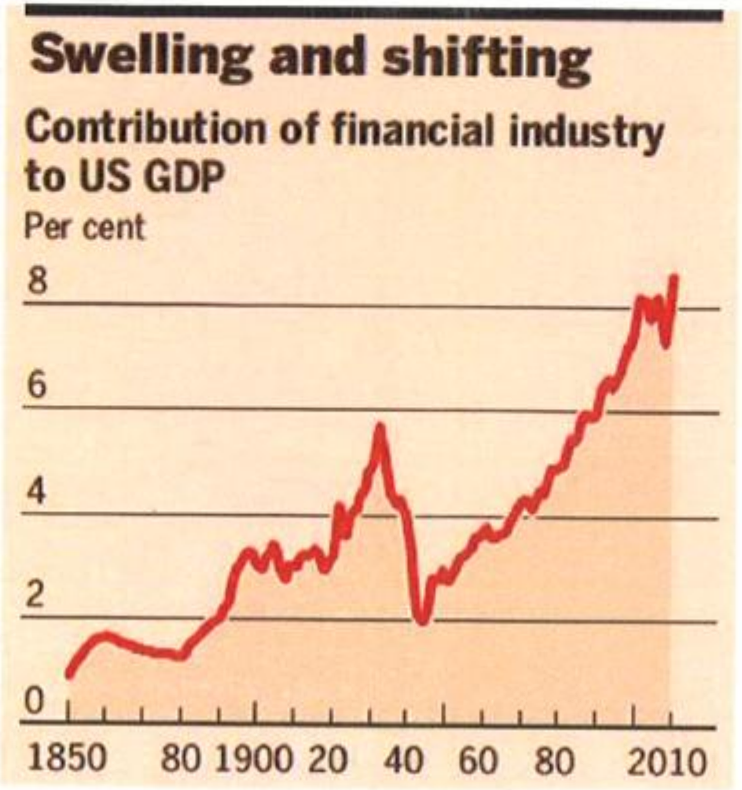
% of disposable personal income, seasonally adjusted



1 This is based on estimates of the foreclosure pipeline in Q2 2011 and ignores future growth in disposable income.

SOURCE: US Federal Reserve; CoreLogic; Haver Analytics; McKinsey Global Institute

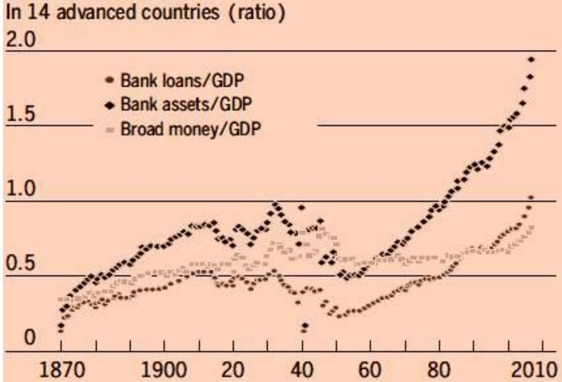
The Exploding Financial Sector-too much Finance?


Swelling and shifting
Contribution of financial industry to US GDP
Per cent
8
6
4
2
0
1850
80
1900
20
40
60
80
2010

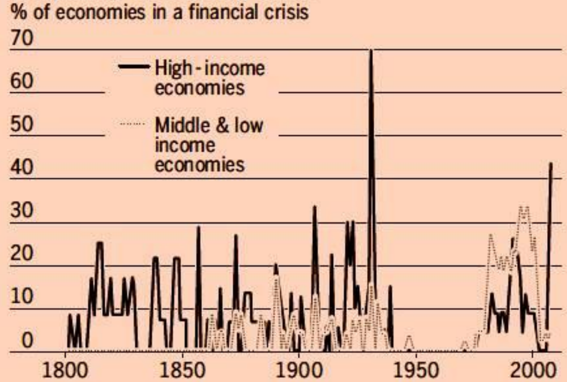
Is there a level above which financial development has a negative effect on growth?

- Yes(IMF)-when credit to the private sector reaches 80-100% of GDP
- Why credit to the private sector?Associated with growth.
- Data:2006,64 countries>50%,27>90%,17>110%(includes Spain,US,UK,Iceland etc)
- Very important for current policy debate on size of banking/finance sector:Basel 3,Dodd-Frank etc-constraining finance constrains growth is the industry mantra….

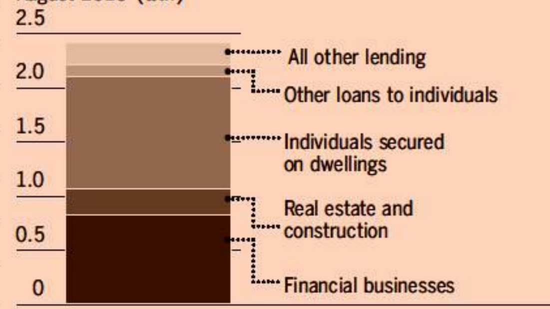
Size of banking sector
In 14 advanced countries (ratio)



Frequency of banking crisis
% of economies in a financial crisis



Loans from monetary financial institutions to UK residents
August 2013 (£tn)



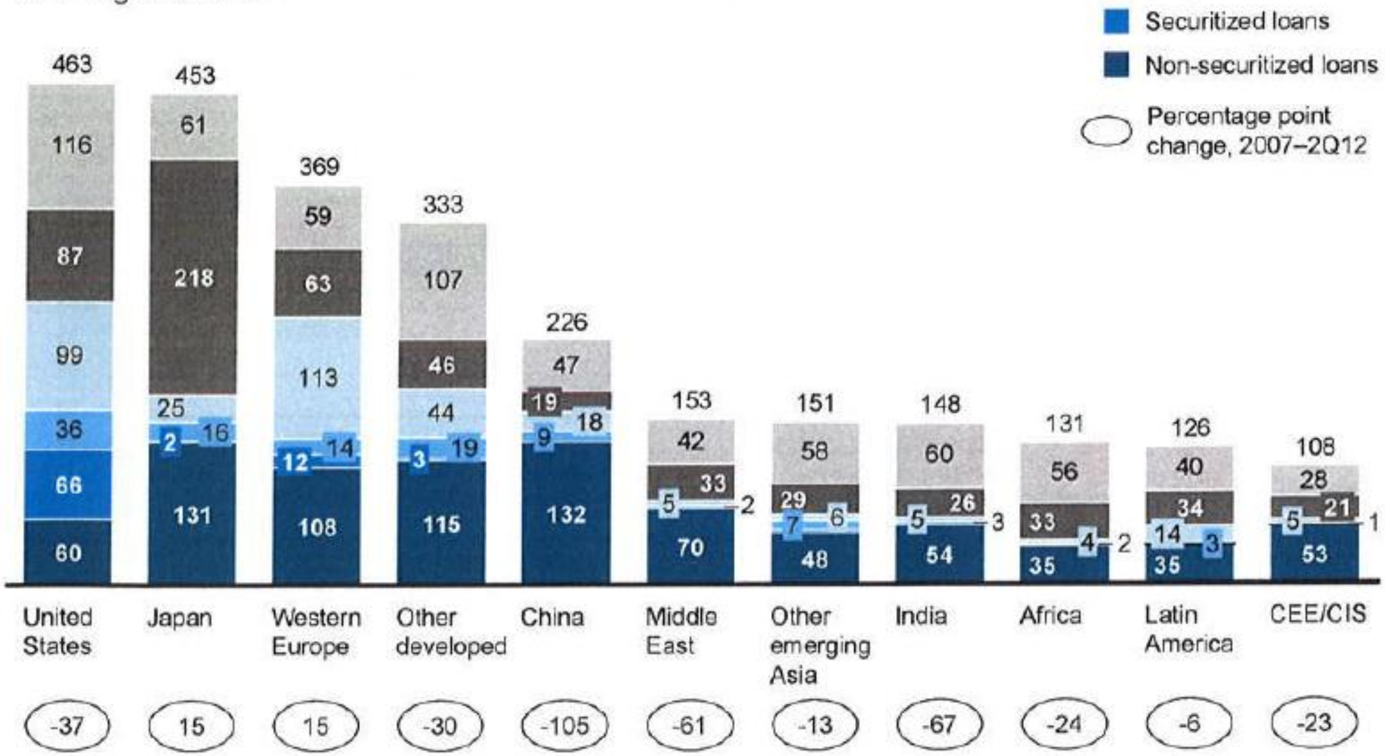
Sources: Schularick and Taylor (2012); Qian, Reinhart, and Rogoff (2010); Bank of England

Exhibit 6

Financial depth in emerging countries is roughly half the level seen in developed economies

Financial depth, 2Q12[1]

% of regional GDP



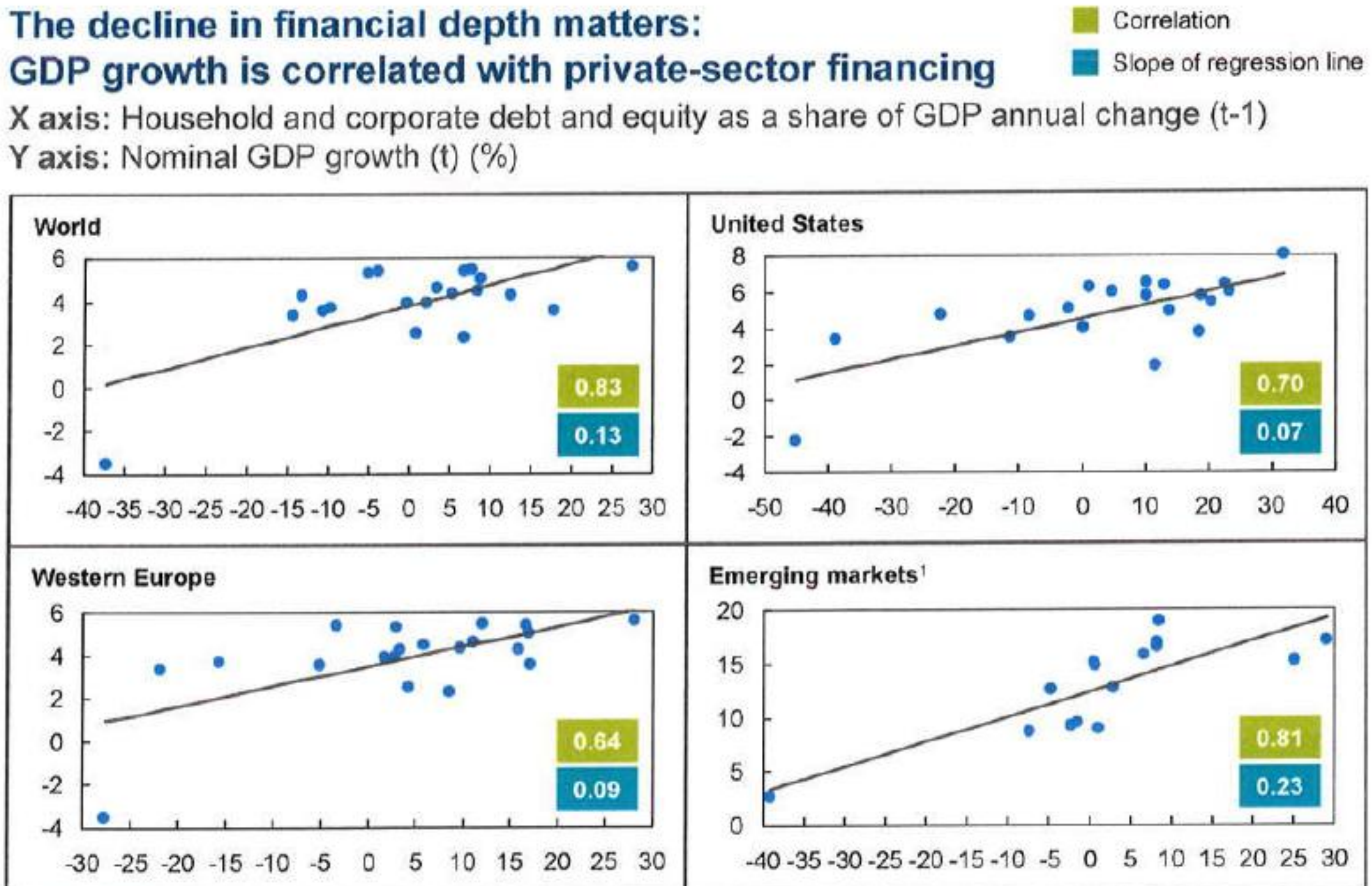
1 Calculated as total regional debt and equity outstanding divided by regional GDP

SOURCE: McKinsey Global Institute Financial Assets Database; McKinsey Global Institute analysis

Exhibit 8

The decline in financial depth matters: GDP growth is correlated with private-sector financing

X axis: Household and corporate debt and equity as a share of GDP annual change (t-1)
Y axis: Nominal GDP growth (t) (%)



1 Emerging markets excluding China shows correlation of 0.66 and a slope of 0.20.
NOTE: Not to scale.
SOURCE: McKinsey Global Institute Financial Assets Database; McKinsey Global Institute analysis

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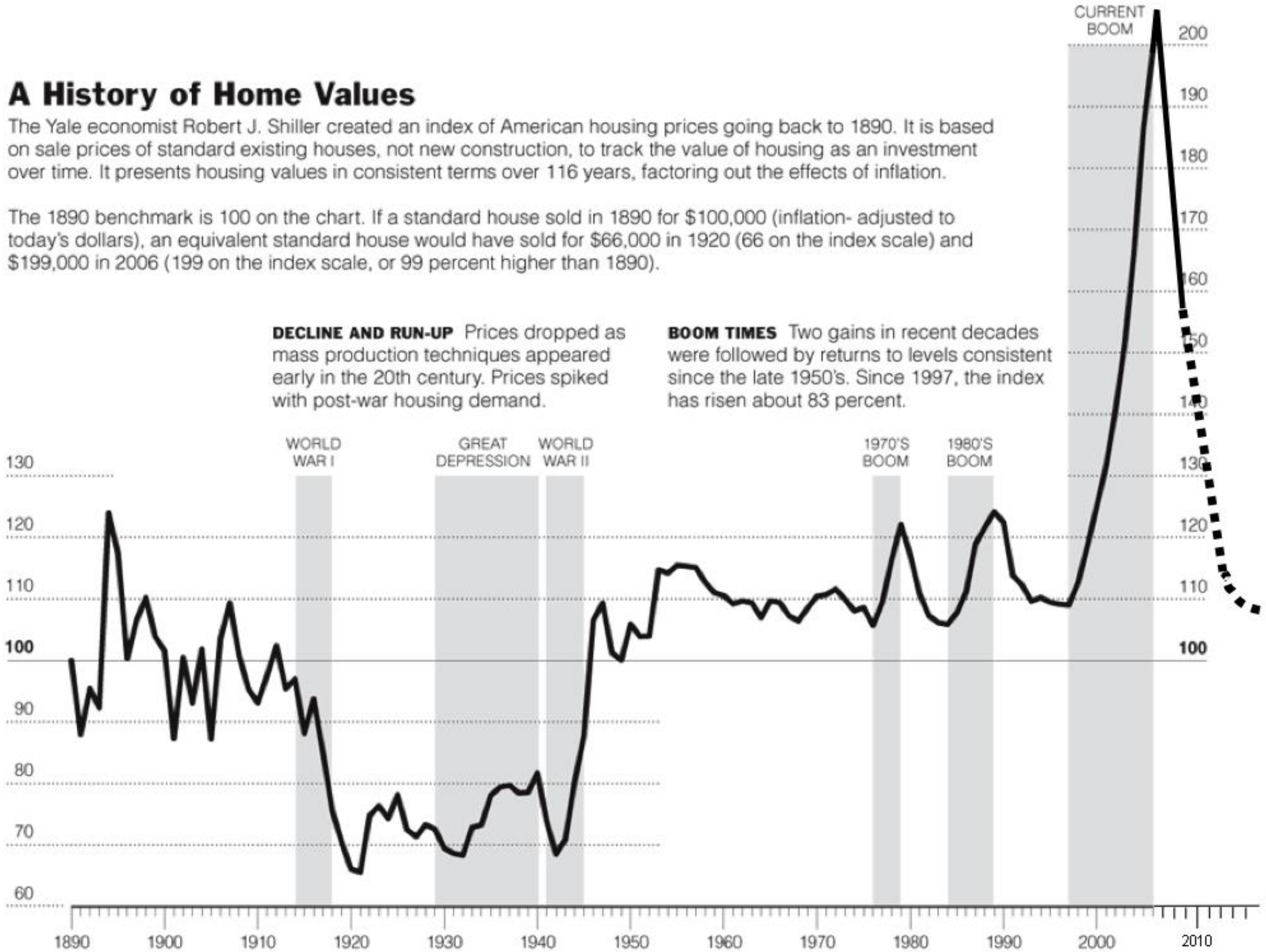
How little do we know!



Source: "Irrational Exuberance," 2nd Edition, 2006, by Robert J. Shiller

Bill Marsh/The New York Times

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Thank you!