



SUMMARY: THE NEW FINANCIAL GLOBAL CAPITAL MARKETS GROWTH INDEX

ANALYSIS OF THE SIZE, DEPTH & GROWTH POTENTIAL OF CAPITAL MARKETS IN 60 ECONOMIES AROUND THE WORLD

January 2019

by William Wright, Panagiotis Asimakopoulos & Eivind Friis Hamre

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> *This unique index shows that capital markets in the US are by far the largest in the world today and are nearly twice the size of markets in Asia and Europe. But capital markets in Asia and emerging markets are catching up fast and are set to dominate the potential growth in global capital markets in the coming decade.*

What this report is about

Two of the biggest economic challenges facing governments around the world are how to ensure that companies have access to a wide range of funding to enable them to raise money to invest in jobs and growth; and how to fund the future retirement income of billions of people many decades from now. If economies are too reliant on bank lending, companies can be starved of vital funding as and when the financial cycle turns - as happened around the world in the wake of the financial crisis. And economies that rely too heavily on pensions systems funded by tomorrow's taxpayers may face an unsustainable burden in providing a decent retirement income for their citizens in the future. Capital markets can help address both of these challenges.

This report analyses - we think for the first time - the size, depth and growth potential of capital markets in 60 economies around the world across 25 different sectors of capital markets activity. It highlights the wide range in the level of development of capital markets between different regions and different economies, and shows that while developed economies have the largest capital markets in terms of sheer size, in many sectors emerging economies have the highest growth potential in both absolute and relative terms in the medium- to long-term.

Large and deep capital markets are not an end in themselves. The value of deeper capital markets is that they support sustainable economic growth in several ways. Healthy capital markets diversify the range of financing for companies and reduce their reliance on bank lending; they boost the shock absorption capacity of an economy and strengthen financial stability; they improve productivity through more efficient allocation of capital; and they provide more people with more opportunities to invest or save towards their retirement. We hope this report helps policymakers and market participants better identify development gaps and growth opportunities and how to address them, and better understand how deeper capital markets can benefit their economies.

The report is made up of the following sections:

- 1) **Headline rankings:** an overall ranking of the size and depth of capital markets by economy and by region
- 2) **Size & depth:** measuring the size and depth of different sectors of the capital markets around the world
- 3) **The growth opportunity:** measuring the potential growth of capital markets around the world
- 4) **Context:** what are the barriers to deeper capital markets and how can policymakers address them?
- 5) **Appendix:** a detailed ranking of the depth of capital markets and their growth potential in each economy

Summary methodology:

We analysed the depth of capital markets across the following 25 different sectors of activity in 60 economies:

- **Pools of capital*:** pensions assets, insurance assets, household financial assets (excluding pensions, insurance and cash deposits)
- **Equity markets:** stockmarket, initial public offerings, secondary equity issues, convertible bonds
- **Bond markets:** value of bond market, value of corporate bond market, investment grade bond issuance, high-yield bond issuance, bank lending relative to corporate bonds
- **Loans & securitisation:** value of outstanding securitisation, securitisation issuance, leveraged loan issuance
- **Assets under management:** assets under management
- **Corporate activity:** M&A by target nationality, M&A by acquiror nationality, domestic M&A
- **Private equity & venture capital:** private equity activity, venture capital activity, private equity fundraising
- **Trading:** equity trading volumes, FX trading, OTC derivatives trading

Acknowledgements:

Thank you to Panagiotis Asimakopoulos and Eivind Friis Hamre for doing most of the heavy-lifting on the research; the Global Financial Markets Association for supporting this project; and our members for supporting our work in making the case for bigger and better capital markets.

** Note: the vast range of different workplace and personal pensions systems around the world makes a direct comparison of pensions assets complicated. In addition, the poor consistency of data on direct retail investment means that we have been unable to include it, which understates the size of pools of capital in economies with highly-developed retail markets such as the US and Canada.*

Bigger and better capital markets

This report argues that bigger and deeper capital markets can help support sustainable economic growth around the world by providing a more balanced and efficient form of funding for companies than bank lending alone, improving productivity through more efficient capital allocation and better risk management, increasing the capacity of economies to absorb economic shocks, and funding more sustainable pensions systems. The starting point for deep and effective capital markets is deep pools of long-term capital such as pensions, insurance assets and retail investment. While the economic and financial system in every economy is unique - and capital markets are at vastly different stages of development - our analysis shows there is huge potential for growth in capital markets around the world.

A 10 point summary of this report:

- 1. Size matters:** The US has by far the largest and most developed capital markets in the world with an average share of more than 44% of capital markets activity across the 25 sectors and 60 economies in our sample. US capital markets are more than twice the size of markets in the EU (21%) and nearly three times the size of markets in China (13%). The US underlines the relationship between deep pools of capital and deep capital markets: it has the largest pools of capital, the largest stock- and bond markets, the largest retail investment market, and the lowest reliance on bank lending as a source of funding of any economy.

The US is one of minority of economies with a bigger share of global capital markets activity than of global GDP: others with highly-developed capital markets include the UK, Canada, Hong Kong, Singapore, Switzerland and Luxembourg. On the flipside, big economies like Brazil, China, Germany, India, and Japan have relatively small capital markets compared with their GDP.

- 2. A wide range in depth:** our analysis of the depth of capital markets across 25 different sectors in 60 economies highlights a wide range in the level of development of capital markets between different regions and individual economies. Capital markets in developed markets are twice as deep relative to GDP as in emerging markets, and the region with the deepest capital markets (North America) is well over twice the depth of markets in the Asia Pacific region or Europe.

Our ranking is dominated by a premier league of six economies with highly-developed capital markets relative to GDP. The top two positions are smaller economies which act as hubs for regional activity: Hong Kong is top with a score of 261 (compared with a global benchmark of 100), and Singapore comes second with 248. They are followed by the US on 170, Luxembourg on 149, the UK on 138, and Canada on 124.

- 3. The rise of Asia:** while capital markets in the Asia Pacific region are on average less than half as deep as in the US, they are catching up fast. They have already overtaken European capital markets both in terms of size (Asia accounts for 27% of global activity compared with 24% for EMEA) and depth relative to GDP. Much of this is driven by China, which accounts for 40% of Asian capital markets activity and which has capital markets that are deeper than those in many large European economies. Even on relatively conservative assumptions, capital markets in the Asia Pacific region are set to experience the most rapid growth over the coming decade.
- 4. The future of Europe:** capital markets in Europe are currently punching below their weight. The EU28 accounts for 23% of the combined GDP in our sample but only 21% of capital markets activity, and capital markets in the EU are less than half as deep relative to GDP as in the US (with an overall depth score of 70 versus 170). A big factor in this relative underdevelopment is the fragmented nature of the European economy, and the fact that many recent members states only started to develop their capital markets from scratch in the early 1990s. The EU's capital markets union initiative to help reduce the cross-border barriers to deeper capital markets could help accelerate the growth of capital markets in future. Brexit has highlighted the urgency of the CMU project: without the UK, capital markets in the rest of the EU27 are around one third smaller and significantly less developed than in the EU28.

A 10 point summary of this report (continued)

5. **The reliance on banks:** in every region outside of North America, companies are still heavily reliant on bank lending for their funding. In the US the split between bank lending and corporate bonds is 26% bank lending and 74% bonds. Economies in Asia and Europe are nearly three times more dependent on bank lending. While there are clear structural differences in banking systems around the world, this reliance exposes these economies to the cyclical nature of bank lending, which can quickly dry up after an economic shock. If companies in the emerging markets reduced their reliance on bank lending from 80% of the borrowing to 70%, it would involve an increase in funding from the corporate bond markets of around \$6 trillion (or double the current value of emerging market corporate bonds).
6. **Deeper pools of capital:** deep pools of long-term capital such as pensions and insurance assets – as well as direct retail investment in funds and securities - are the starting point for deep and effective capital markets. But in Europe they are only half as deep relative to GDP as in the US, and in Asia just a quarter as deep. While households in Europe and Asia save more than in the US, there is huge potential to shift more of these savings into long-term pools of capital by developing pensions systems and encouraging more retail investment. In the US, just 12% of household financial assets are held in bank savings, compared with more than 30% in Europe and over 40% in Asia. If households in Asia and Europe switched one third of their cash savings into longer-term investments it would transfer around \$12 trillion into long-term pools of capital.
7. **The huge potential for growth:** we estimate that over the next 10 years global capital markets activity could grow by between 40% and 70% in real terms in sectors like IPOs and corporate bond issuance, which would significantly reduce the reliance of companies in many economies on bank lending and support more sustainable economic growth. Global pools of long-term capital will increase by around one third (equivalent to \$24 trillion in real terms) as billions of people become wealthier and more economies around the world introduce and develop workplace and private pensions systems to address the looming demographic timebomb.
8. **A shift in the balance of power:** capital markets activity in emerging markets is likely to grow at between two and four times the rate of developed markets. In absolute terms, markets in the Asia Pacific will account for as much as two thirds of the growth over the coming decade in sectors such as stockmarkets, IPOs and corporate bonds. In most sectors, the potential growth in Asia is two to four times larger than in EMEA in terms of value, and Asia will increase its share of global capital markets activity from around one third today to just under a half over the next 20 years.
9. **The bigger picture:** capital markets do not exist in a vacuum and bigger and deeper capital markets will not happen on their own. Efficient capital markets rely on a thriving business environment, stable government, and high levels of trust in the rule of law. Economies that want to develop deeper capital markets to support their economies will need to focus on wider issues such as structural economic reform rather than narrow regulation of banking and financial markets. Economies that are open and competitive are more likely to enjoy flourishing capital markets. (see section on policy from page 20).
10. **Laying the foundations:** there are plenty of measures that governments and regulators can take to support the growth of deep and effective capital markets, from encouraging the formation of pools of capital through the development of workplace and private pensions; promoting better financial literacy and a retail investment culture; ensuring and maintaining high standards of market integrity and investor protection; calibrating the need for high standards of supervision and regulation with the need for innovation and growth; and opening up capital markets to greater competition. While many of the barriers to deeper capital markets are national, the increasingly interconnected global economy means that some of these challenges can only be addressed at a cross-border, regional or global level.

THE SIZE OF GLOBAL CAPITAL MARKETS

Size matters

The starting point for any analysis of the depth and growth potential of capital markets around the world is understanding how big they are today. And the inescapable conclusion is that when it comes to capital markets, the US is in a league of its own.

Fig.1 ranks economies by the size of their capital markets, as measured by the average share of global capital markets activity across the 25 sectors in our sample. We chose this approach to make it easier to include sectors of vastly different value (for example, the value of stockmarkets runs into the trillions of dollars in large economies, while in all but a handful of economies venture capital investment is measured in the tens of millions).

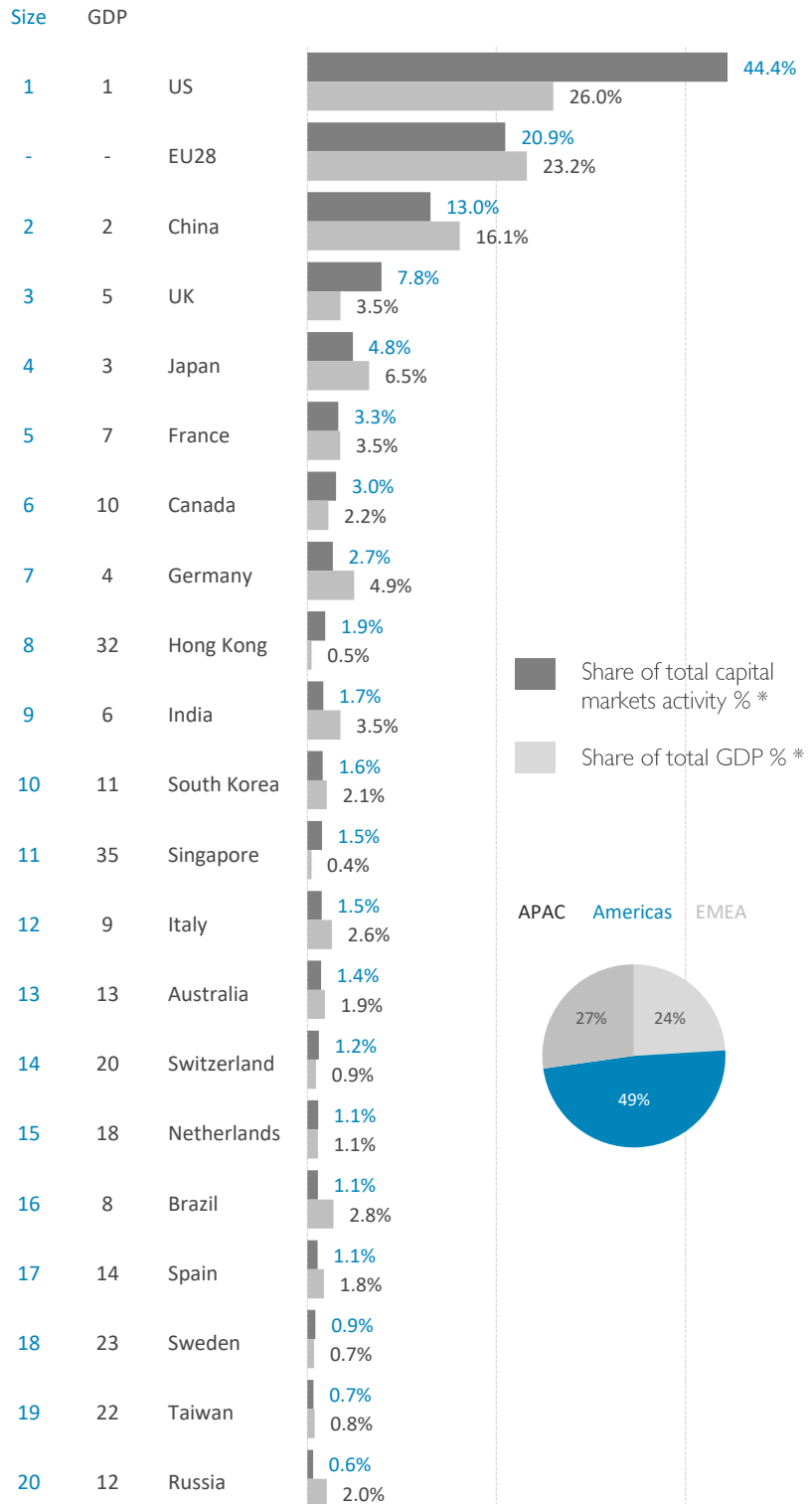
The US dominates the ranking with an average share of more than 44% of total capital markets activity across the 25 sectors and 60 economies in our sample. Capital markets in the US are more than twice the size of markets in the EU, and not far short of three times the size of markets in China. The US has the largest market in 22 out of the 25 sectors that we analysed: the only three sectors where the US is not the largest market in the world are IPOs (where it is second to China) and the value of trading in foreign exchange and OTC derivatives (where it is second to the UK).

The chart also highlights the disparity between the value of capital markets activity and GDP. For example, capital markets in the US are more than twice as big as in the EU even though the US economy is only around 10% larger. The US is one of handful of economies – including the UK, Canada, Hong Kong, Singapore and Switzerland – where capital markets are bigger than you would expect based on the size of GDP. On the flipside, China, Japan, India, Germany and Brazil have capital markets that are significantly smaller than the size of their economy would suggest.

Overall, the Americas account for 49% of global capital markets activity, almost as much as the Asia Pacific region (27%) and EMEA (24%) combined.

Fig.1 The size of capital markets around the world

Size of capital markets by economy measured by the average share of total activity across 25 different sectors in 2017 %



* Note: % share based on our sample of 60 economies

Source: New Financial

THE DEPTH OF GLOBAL CAPITAL MARKETS

A wide range

Our ranking measures the size of capital markets relative to GDP and highlights the wide range in the level of development and depth of capital markets around the world.

The ranking is dominated by two smaller economies that act as regional hubs for capital markets activity. Across the 25 sectors in our sample, Hong Kong is top of the ranking with an overall score of 261, just ahead of Singapore in second place on 248, and more than double the global benchmark of 100. The US - which has by far the largest capital markets in the world by value - ranks third for depth on 170, with the UK fifth on 138.

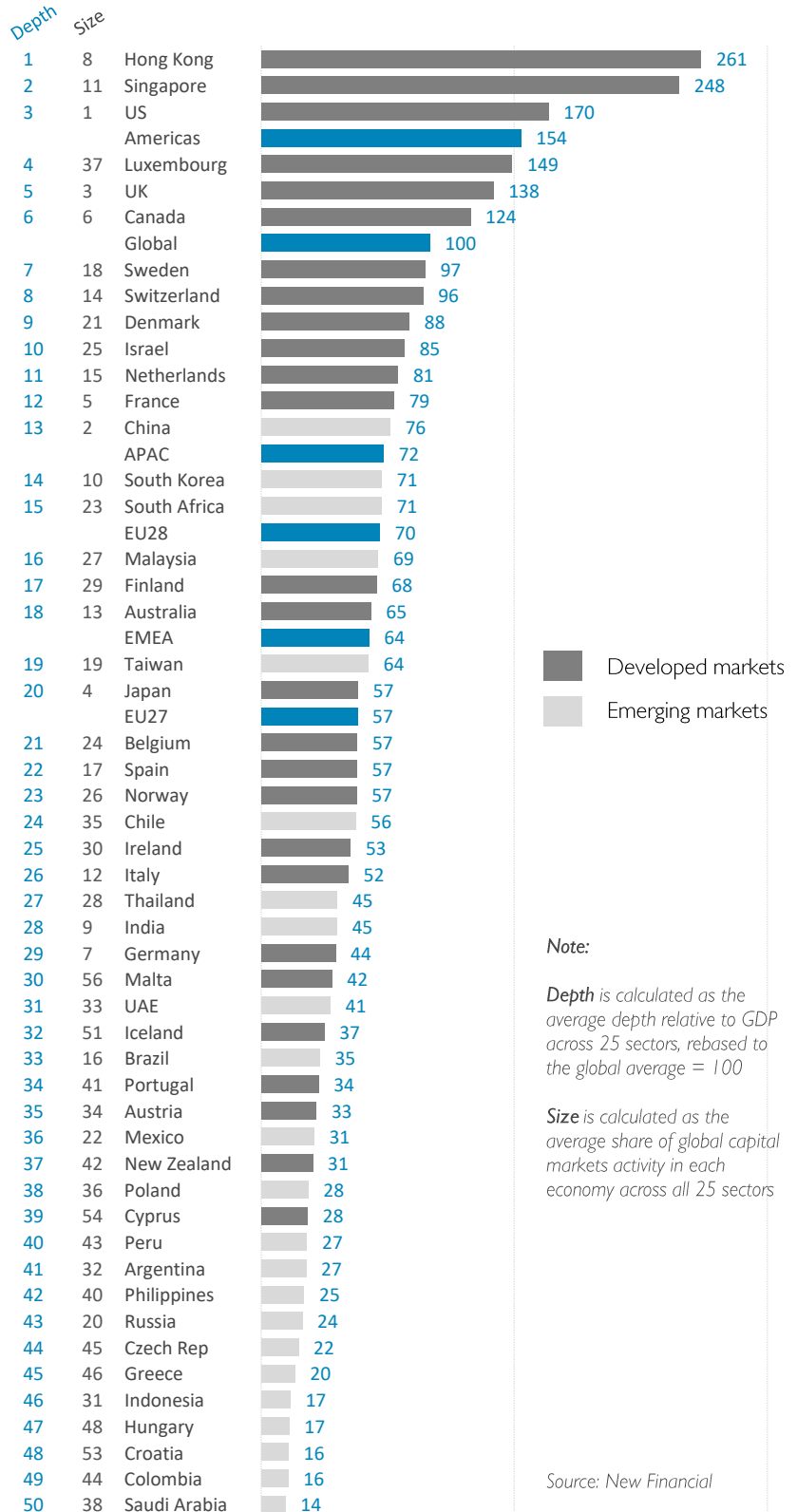
The US, UK and Canada all have capital markets that are both large and deep: between them they account for 55% of global activity. But in many markets there is a disconnect between the depth and size of capital markets. Some smaller economies - such as Luxembourg - have very deep but relatively small capital markets. While Luxembourg ranks fourth overall in terms of the depth of capital markets relative to GDP, it only has the 37th largest capital markets measured by its average share of global activity (just 0.2%).

And some large economies such as China, Japan and Germany, have capital markets that are very large but are under-developed relative to their GDP. China has the second largest but only the 13th deepest capital markets, while Japan has the fourth largest but only the 20th deepest capital markets. Developed markets dominate our ranking, filling the top 10, and taking 15 of the top 20 positions. The highest ranked emerging market is China in 13th place, just ahead of South Korea and South Africa.

There are several surprises in the rankings: Israel in 10th place earns one third of its ranking from its outsize venture capital sector (without which it would be mid-table at around the same level as Belgium). And India in 28th scores surprisingly well, boosted by venture capital, private equity and IPOs. Germany ranks 29th, behind the likes of India and Italy, with capital markets less than a third as deep as the UK.

Fig.2 The range in depth of capital markets by economy

Average depth of capital markets by economy relative to GDP across 25 sectors of activity in 2017. Rebased to 100 = global average



THE GROWTH POTENTIAL IN GLOBAL MARKETS

The huge potential for growth

We estimated the growth opportunity across the different sectors of the capital markets for each economy in three 'what if?' scenarios based on historic growth of capital markets and GDP. Our headline numbers are the average of these three scenarios.

Over the next 10 years global capital markets could grow in real terms by an average of nearly 50%. In some sectors like IPOs and corporate bond issuance activity is set to increase by as much as 70% in real terms. This would significantly reduce the reliance of companies in many economies on bank lending to support more sustainable economic growth.

Capital markets in Asia and emerging markets are likely to grow at the fastest rate. In our ranking, almost half of the 20 economies with the highest growth potential are in the Asia-Pacific region while more than three quarters are emerging market economies. Capital markets in these economies are set to grow by more than 50%.

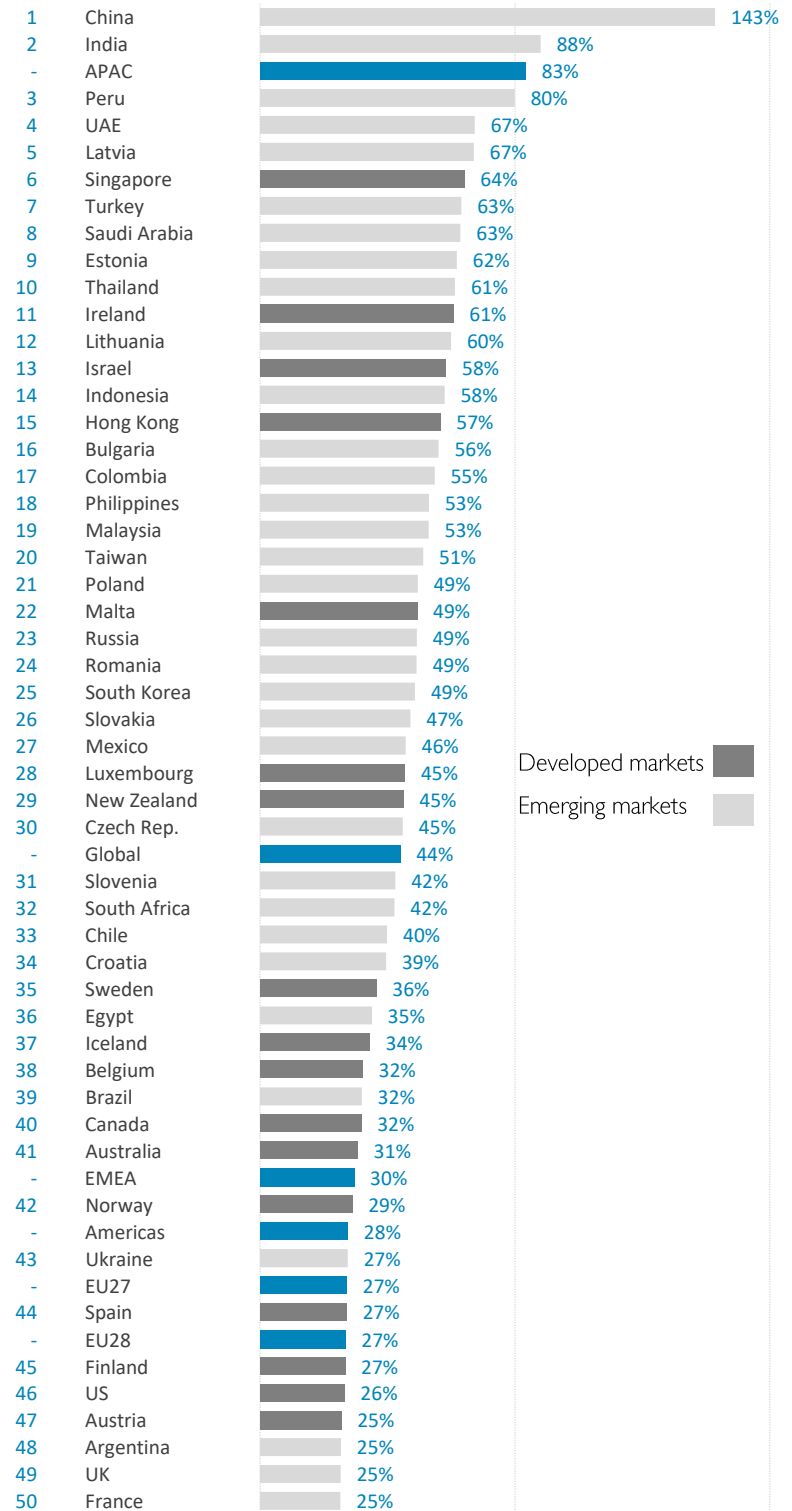
China has by far the largest growth potential. We estimate that capital markets in China will more than double over the next decade, closely followed by markets in India and Peru, which will grow by more than two thirds.

US capital markets, which are by far the biggest in the world today in terms of size, and capital markets in the UK (3rd biggest), will grow at the same rate, by around a quarter. Smaller economies with highly developed and deep capital markets such as Singapore, Hong Kong and Luxembourg will grow more, by between a half and two thirds.

European capital markets could grow by around a quarter over the next decade, but there is a wide range in potential growth across the region. In smaller EU economies such as Latvia, Estonia, Lithuania, Bulgaria and Poland, capital markets are set to grow by more than 50% bigger whereas the more developed markets of the block such as Sweden, Spain, and Belgium will experience a more moderate growth.

Fig.3 The potential growth of capital markets around the world

Average potential growth by economy over the next decade in pools of capital, capital markets financing, stockmarkets and corporate bond markets, %



Source: New Financial

THE SHARE OF FUTURE GROWTH

The drivers of growth

Our ranking shows the contribution of each economy to the total potential growth of global capital markets. It highlights the likely dominance of capital markets in Asia-Pacific and their huge growth potential over the coming decade: more than half of the potential growth in global capital markets will come from economies in Asia in the next 10 years.

The split between developed and emerging markets is almost even: a little more than 45% of the potential growth in global capital markets will come from emerging markets, mainly from the likes of China, India and South Korea, Taiwan, South Africa and Brazil.

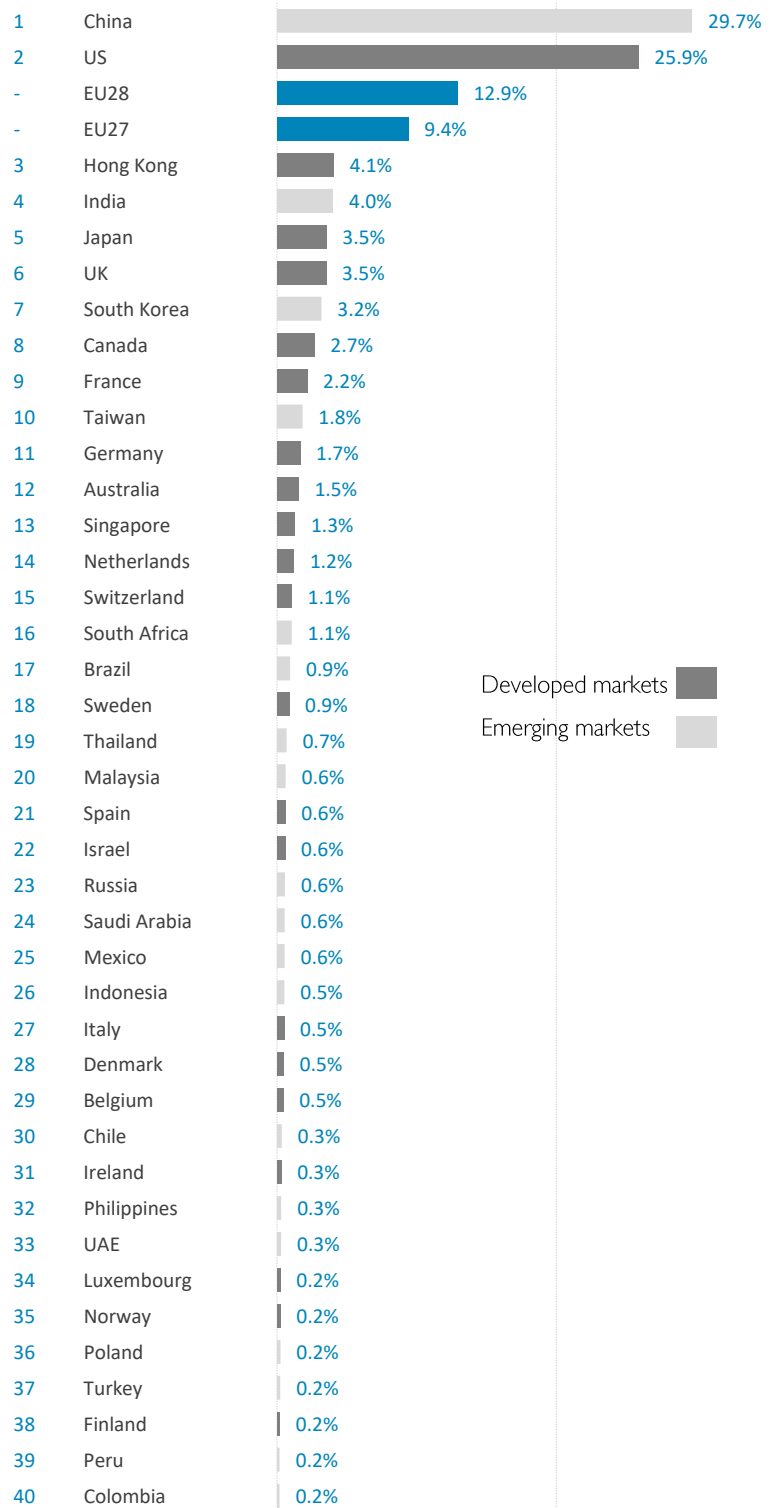
The US and China, the two largest economies in the world are in a league of their own: their combined share of potential growth is more than half of the total in global capital markets. China is set to have the largest share of global potential growth with about 30%, closely followed by the US, which will account for around a quarter of the total growth.

We estimate that every other economy in our sample will have a share of less than 5% of the potential growth in global capital markets. With the exception of India, in which activity is expected to nearly double over the next decade, the share of most countries in the potential global capital markets growth is more of a reflection of their current share and the current level of development of their capital markets.

European capital markets are set to contribute around 15% of the total growth in global capital markets, although the EU27 will be responsible for just 10% of global growth. The countries with the biggest share will be the UK (3.5%), France (2.2%), Germany (1.7%) and the Netherlands (1.2%) which together account for more than half of the total growth in EU capital markets over the next decade.

Fig.4 The contribution in global capital markets growth

The share of potential global growth of capital markets by economy, %



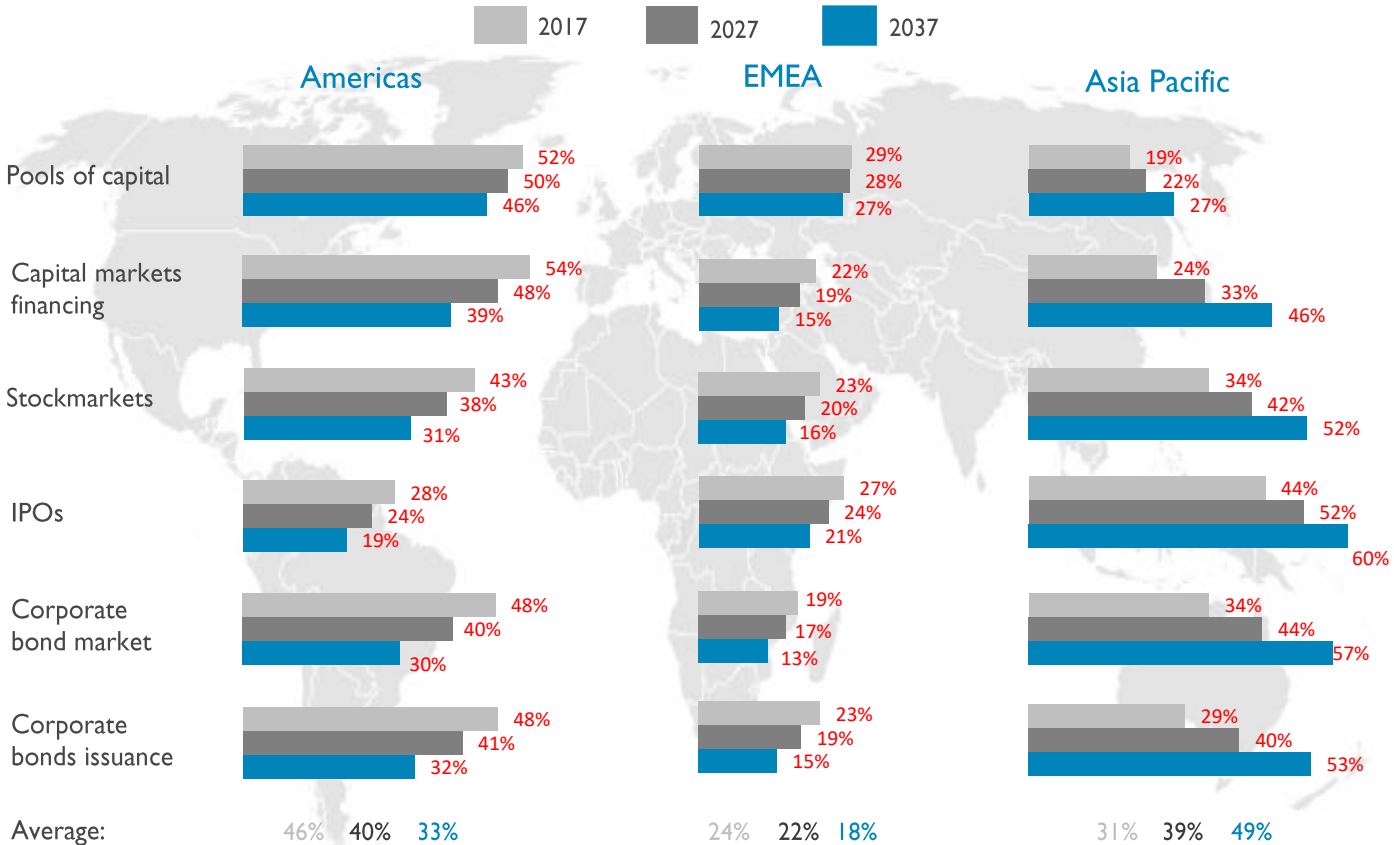
Source: New Financial

THE FUTURE OF GLOBAL CAPITAL MARKETS

Fig.5 The changing face of capital markets

The regional share of capital markets activity in selected sectors today and the forecast share in 10 and 20 years.

Note: this chart does not represent the absolute size of capital markets activity but the changing balance of activity between different regions according to our analysis of potential growth based on the growth trends over the past 10 to 20 years.



A global shift

If the past 20 years are anything to go by, Asian markets are set to dominate the global capital markets over the next few decades. Using a selection of the sectors where we have the most robust historical data and which we believe are broadly representative of the overall direction of capital markets, we estimate that the balance of power will swing decisively towards Asia over the next 10 to 20 years. The overall share of Asian markets will increase from an average of 31% today to 39% in 10 years' time and as much as 49% in 20 years if you extrapolate our analysis of potential growth out to 2037. We estimate that roughly half of this growth will come from China alone.

The biggest area of growth for Asian markets will be the annual flow of capital markets financing, which our analysis suggests will nearly double from 24% of global activity today to 46% in 20 years. If that sounds fanciful, note that our estimate assumes that growth in GDP and market depth will continue at around half the rate in future than the rate at which it has grown over the past few decades.

On average, on current trends, EMEA would shrink in relative terms from one quarter of global capital markets activity today to 22% in 10 years' time and just 18% by 2037. This underlines the urgency of the capital markets union initiative and wider efforts to develop capital markets in Europe. The Americas would shrink from 46% today to 40% on a 10 year horizon: some time around 2030, the Asia Pacific region would overtake the Americas in terms of global market share, and by around 2040 Asia would account for more than half of all global capital markets activity.

About New Financial

New Financial is a think tank that believes Europe needs bigger and better capital markets to help drive growth and prosperity.

We think this presents a huge opportunity for the industry and its customers to embrace change and rethink how capital markets work.

We work with market participants and policymakers to help make a more positive and constructive case for capital markets around four main themes: unlocking capital markets; rebuilding trust; driving diversity; and the impact of Brexit.

We are a social enterprise that launched in September 2014. We are funded by institutional membership from different sectors of the capital markets industry.

For more information on our work, contact us on:

New Financial LLP

23 Grafton Street
London W1S 4EY
UK

www.newfinancial.org

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[@NewFinancialLLP](https://twitter.com/NewFinancialLLP)

William Wright

Managing director

william.wright@newfinancial.org

+44 20 3743 8269

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GFMA's mission is to provide a forum for global systemically important banks to develop policies and strategies on issues of global concern within the regulatory environment.

The GFMA brings together three of the world's leading financial trade associations to address the increasingly important global regulatory agenda and to promote coordinated advocacy efforts:

The Association for Financial Markets in Europe (AFME) in London, Brussels and Frankfurt, the Asia Securities Industry & Financial Markets Association (ASIFMA) in Hong Kong and the Securities Industry and Financial Markets Association (SIFMA) in New York and Washington are, respectively, the European, Asian and North American members of GFMA.

For more information on our work, contact us on:

Global Financial Markets Association

1101 New York Avenue, 8th Floor
Washington, DC 20005
USA

www.gfma.org