Future of long-term finance

Club HEC - Finance

Jean-Christophe Mieszala
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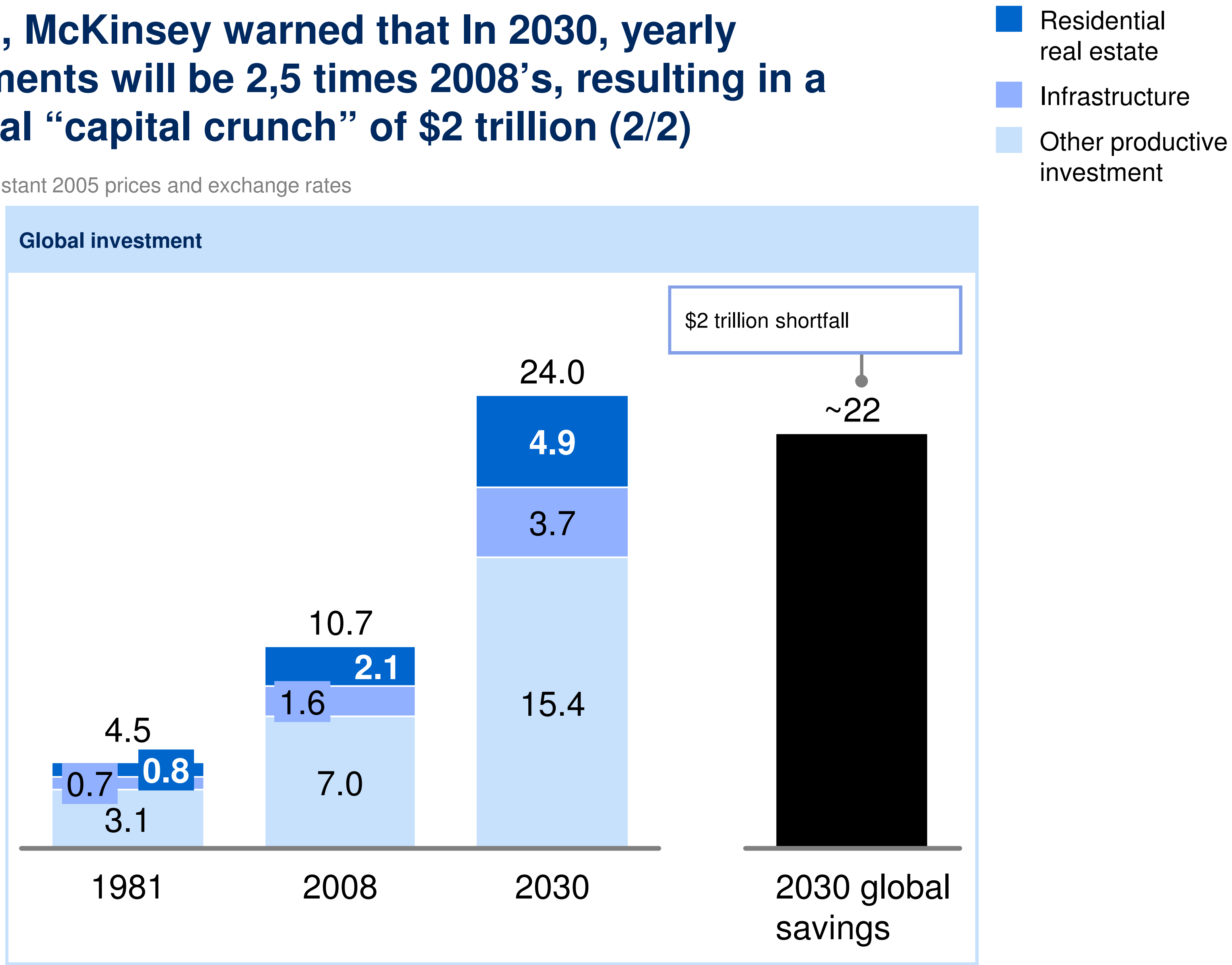
McKinsey&Company

In 2009, McKinsey warned that In 2030, yearly investments will be 2,5 times 2008's, resulting in a potential "capital crunch" of $2 trillion (2/2)

$ Trillions, constant 2005 prices and exchange rates



SOURCE: Economist Intelligence Unit; Global Insight; McKinsey Global Economic Growth Database; Oxford Economics; World Development Indicators of the World Bank; MGI Capital Supply & Demand Model; McKinsey Global Institute

First order effects of the financial crisis at individual banks have fueled a debate about broader economic effects

First order effects at individual banks

Many incumbents **refocus on core segments** and **strengthening** their credit and commercial processes

Some segments (e.g., structured finance, Large Caps) face a short-term, and mostly **delicate market balance** at best

Banks **withdraw from long-term lending** causing corporates to seek alternative funding channels

… Fostering a debate about broader economic effects

- Politicians and regulators are especially concerned about a potential undersupply of long-term corporate credit ("credit crunch") threatening future economic growth
- This has been raised by the Group of Thirty: “Woringly, we conclude that the current systems […] do a poor job in supplying long-term finance from diverse providers to lenders spread across sectors and the globe."
- And the European commission just published a Green Paper with 30 consultation questions to initiate a broad debate about "how to foster the supply of long-term financing and how to improve and diversify the system of financial inter-mediation for long-term investment in Europe"

SOURCE: McKinsey; Group of Thirty; EC

The working group on long-term finance (G30)

Working group

Jacob A. Frenkel
Chairman of the Board of Trustees, The Group of Thirty
Chairman, JPMorgan Chase International
Former Governor, Bank of Israel

Jaime Caruana
General Manager, Bank for International Settlements
Former Chairman, Basel Committee on Banking Supervision

Guillermo de la Dehesa
Director & Member of the Executive Committee, Banco Santander
Former Deputy Managing Director, Banco de España

William J. McDonough
Former President, Federal Reserve Bank of New York

Jean-Claude Trichet
Chairman, The Group of Thirty
Honorary Governor, Banque de France
Former President, European Central Bank

Domingo Cavallo
Chairman & CEO, DFC Associates, LLC
Former Minister of Economy, Argentina

Roger Ferguson
President & CEO, TIAA-CREF
Former Vice Chairman, Board of Governors of the Federal Reserve System

Peter Sands
Group CEO, Standard Chartered PLC
Former Group Finance Director, Standard Chartered PLC

Geoffrey Bell
Executive Secretary, The Group of Thirty
President, Geoffrey Bell and Company, Inc.

E. Gerald Corrigan
Managing Director, Goldman Sachs Group, Inc.
Former President, Federal Reserve Bank of New York

Gerd Haeusler
CEO, Bayerische Landesbank
Former Managing Director & Vice Chairman,Lazard & Co.

Martin Senn
CEO, Zurich Insurance Group Ltd.
Former CIO, Swiss Life Group

Leszek Balcerowicz
Professor, Warsaw School of Economics
Former Deputy Prime Minister & Minister of Finance, Poland

Jacques de Larosière
President, Eurofi
Former Managing Director, IMF

John Heimann
Senior Advisor, Financial Stability Institute
Former US Comptroller of the Currency

Jose Viñals
Financial Counsellor & Director of Monetary and Capital Markets, IMF
Former Deputy Governor, Banco de España

Mark Carney
Governor, Bank of Canada
Chair, Financial Stability Board
Member of the Board of Directors, Bank for International Settlements

Richard A. Debs
Advisory Director, Morgan Stanley
Former President, Morgan Stanley International

Philipp Hildebrand
Vice Chairman, BlackRock
Former Chairman of the Governing Board, Swiss National Bank

Sir David Walker
Chairman, Barclays PLC
Former Chairman, Morgan Stanley International, Inc.

Observers

Peter Buomberger
Zurich Insurance Group Ltd.

Steven Hottiger
UBS

Anna Marrs
Standard Chartered PLC

Project director

Charles Roxburgh
McKinsey & Company

Experts

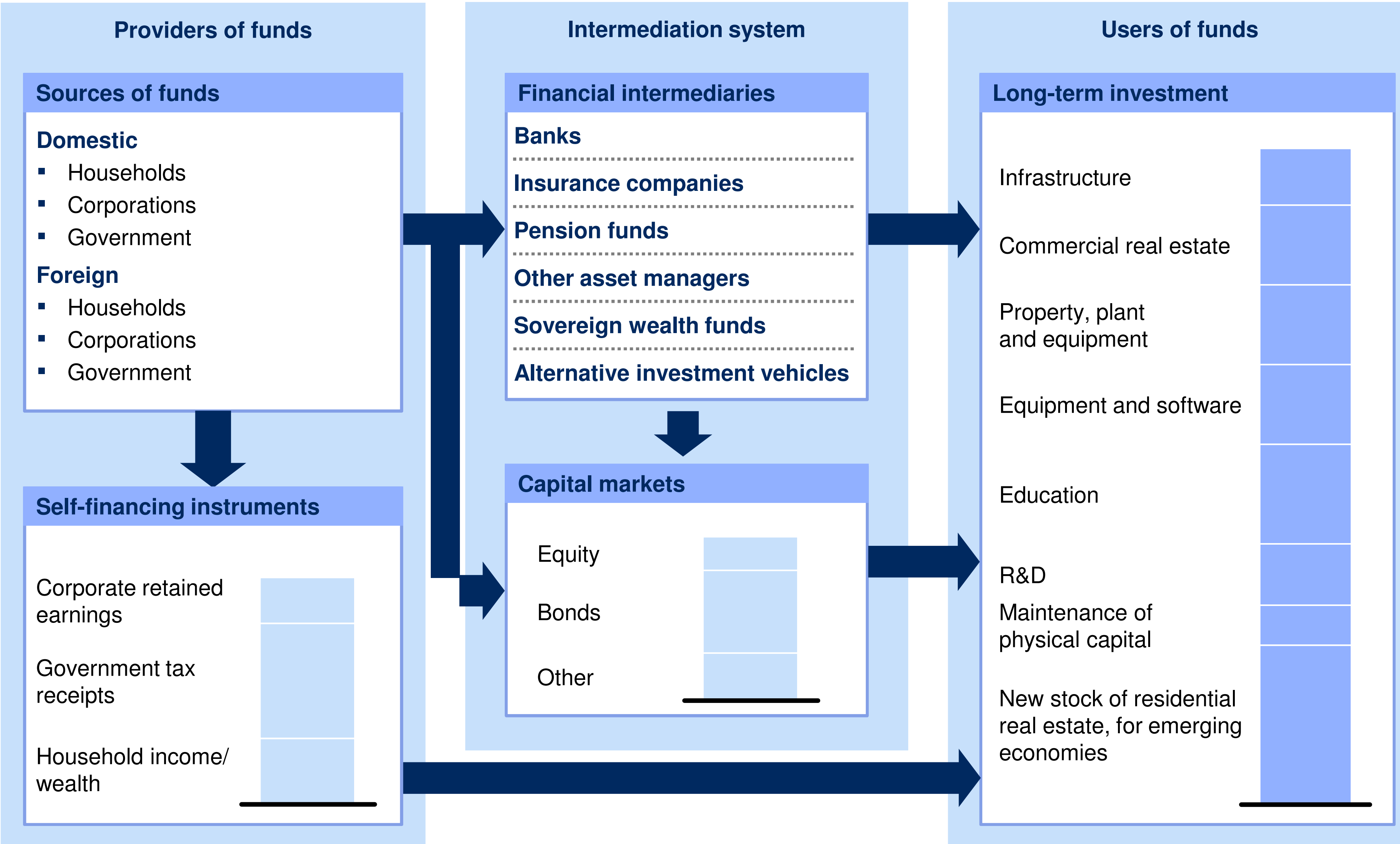
Several McKinsey Partners
McKinsey & Company

McKinsey Global Institute
McKinsey & Company

Stuart P.M. Mackintosh
Group of Thirty

SOURCE: Group of Thirty

Framework for understanding the provision of financing for long-term investment

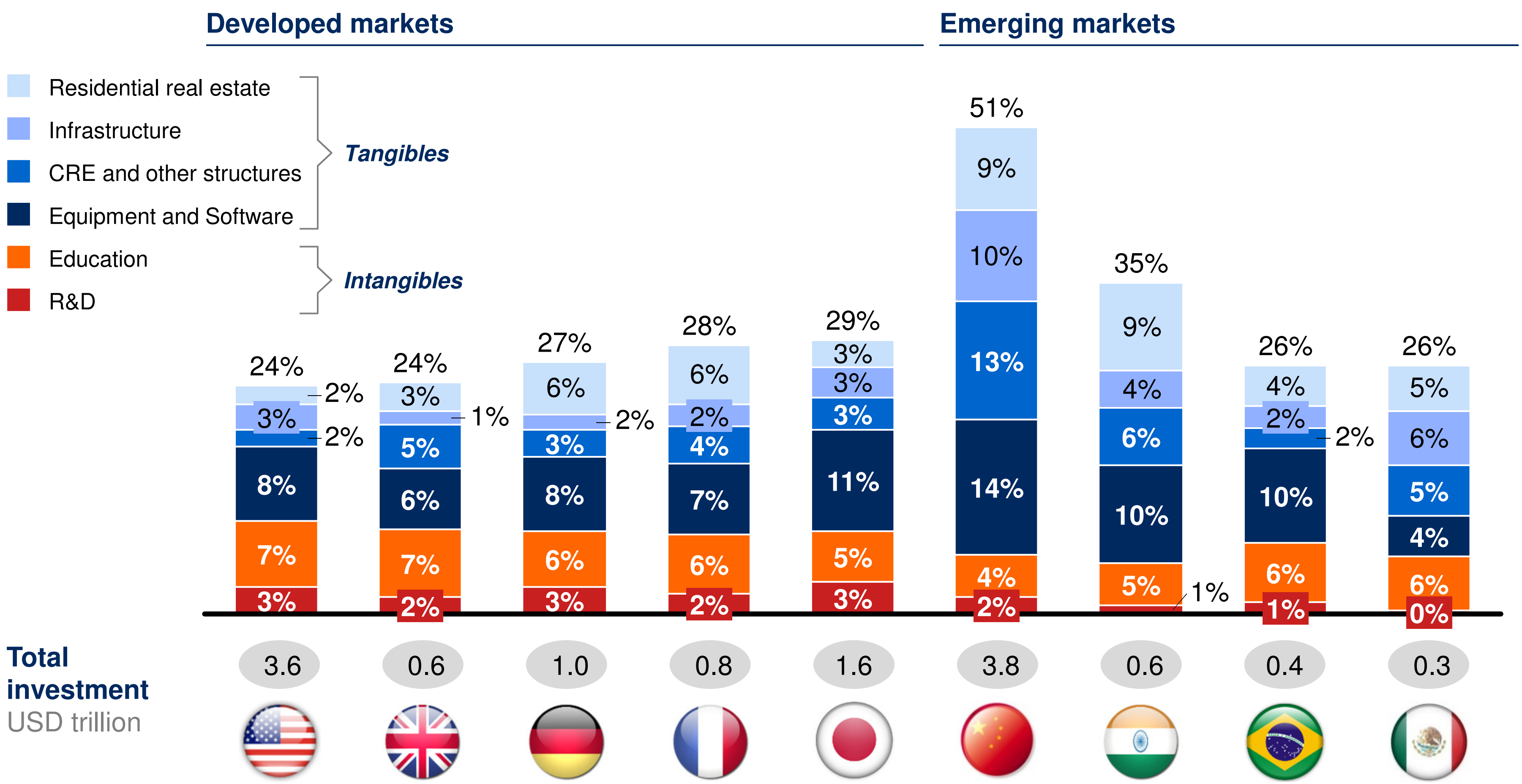


SOURCE: McKinsey Global Institute.

Long-term investment typically represents 25–30% of GDP, though it can be much higher in economies undergoing rapid economic transformation

Long-term investment breakdown by asset type for 9 sample countries

Percent of GDP, most recent data (2011 or 2010), country sample represents over 60% of world GDP

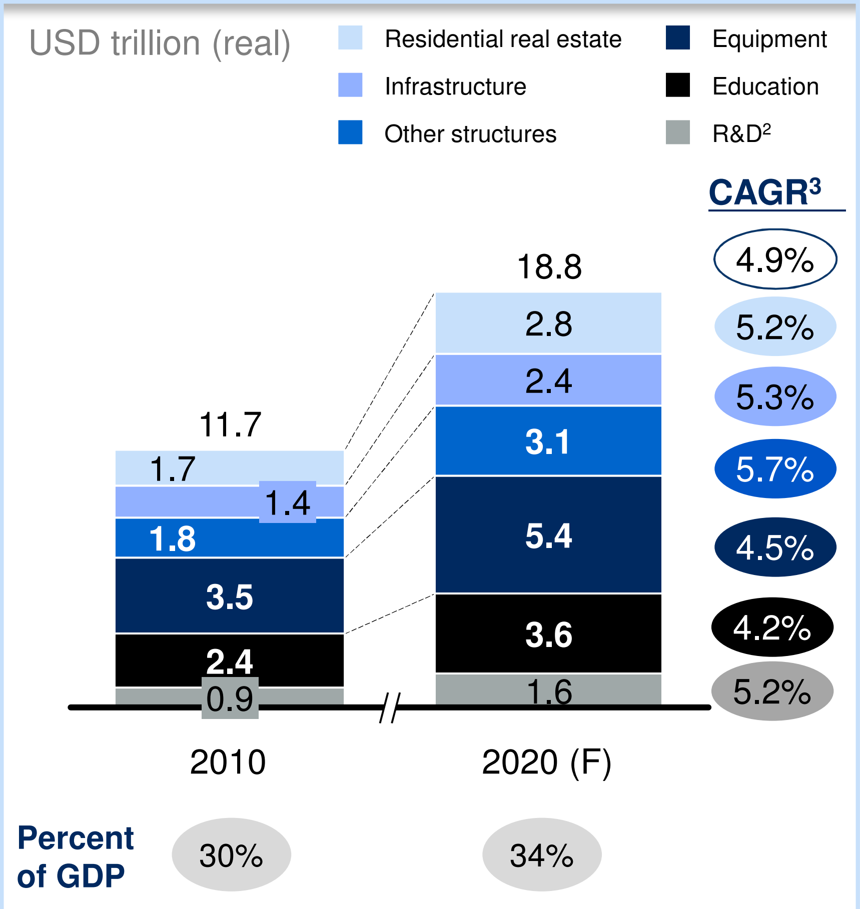


SOURCE: McKinsey Global Institute.

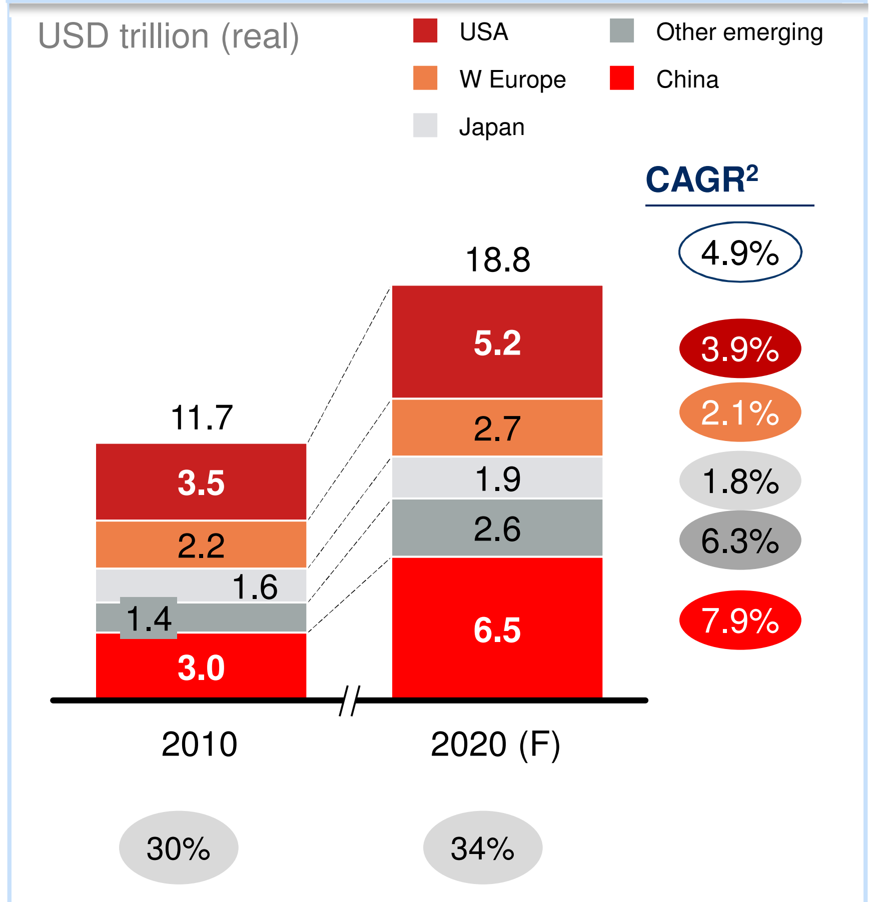
In a consensus growth scenario, long-term investment is projected to grow significantly by 2020

Constant 2010 prices, constant exchange rates

Real investment by type for sample countries[1]



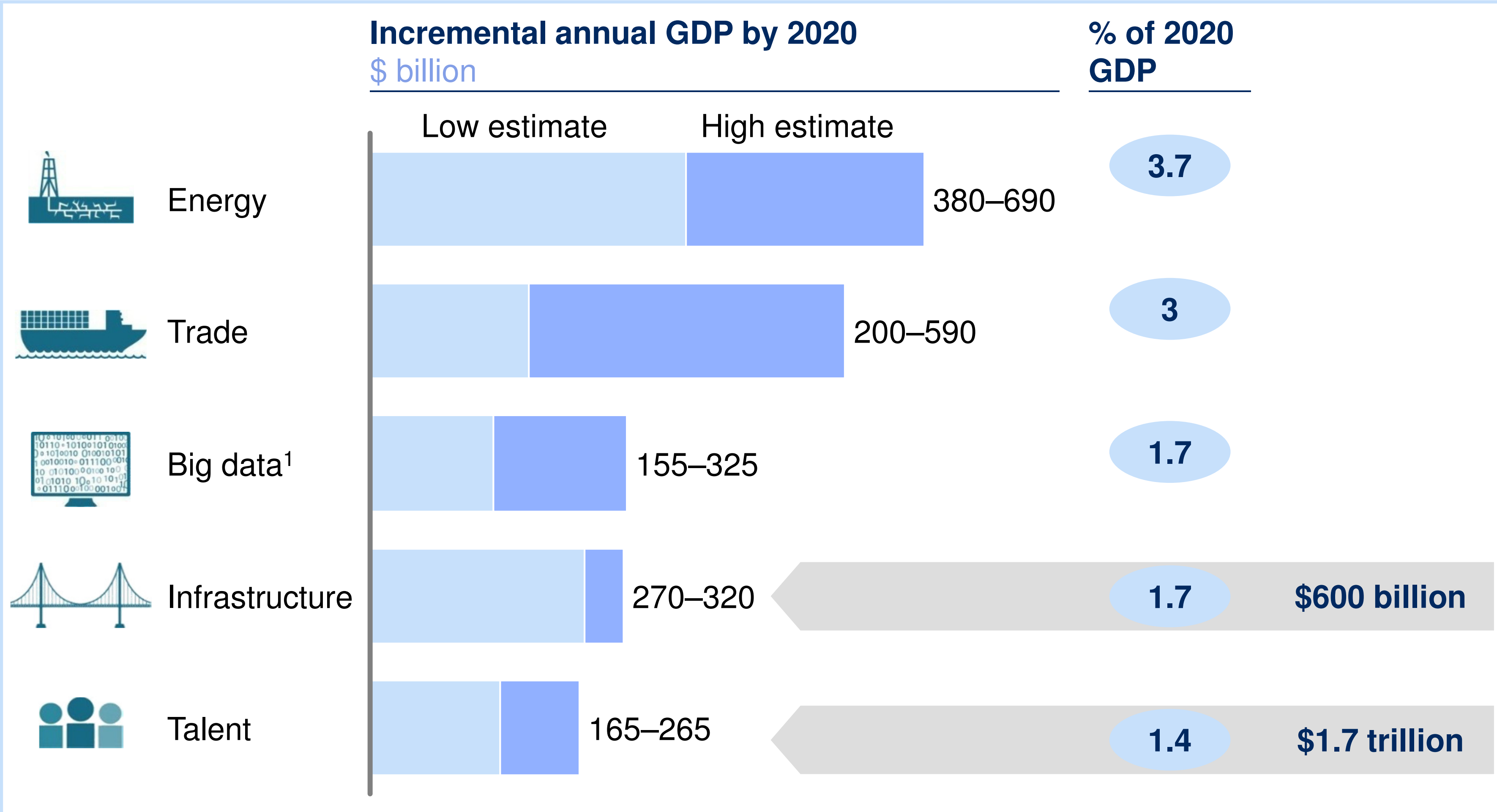
Investment evolution by region for sample countries[1]



1 Sample countries include Brazil, China, France, Germany, India, Japan, Mexico, UK, and US, representing 60% of world GDP in 2010.
2 Research and development.
3 Cumulative annual growth rate.

SOURCE: McKinsey Global Institute.

Example: the five game changers which substantially raise US GDP by 2020 require significant investments

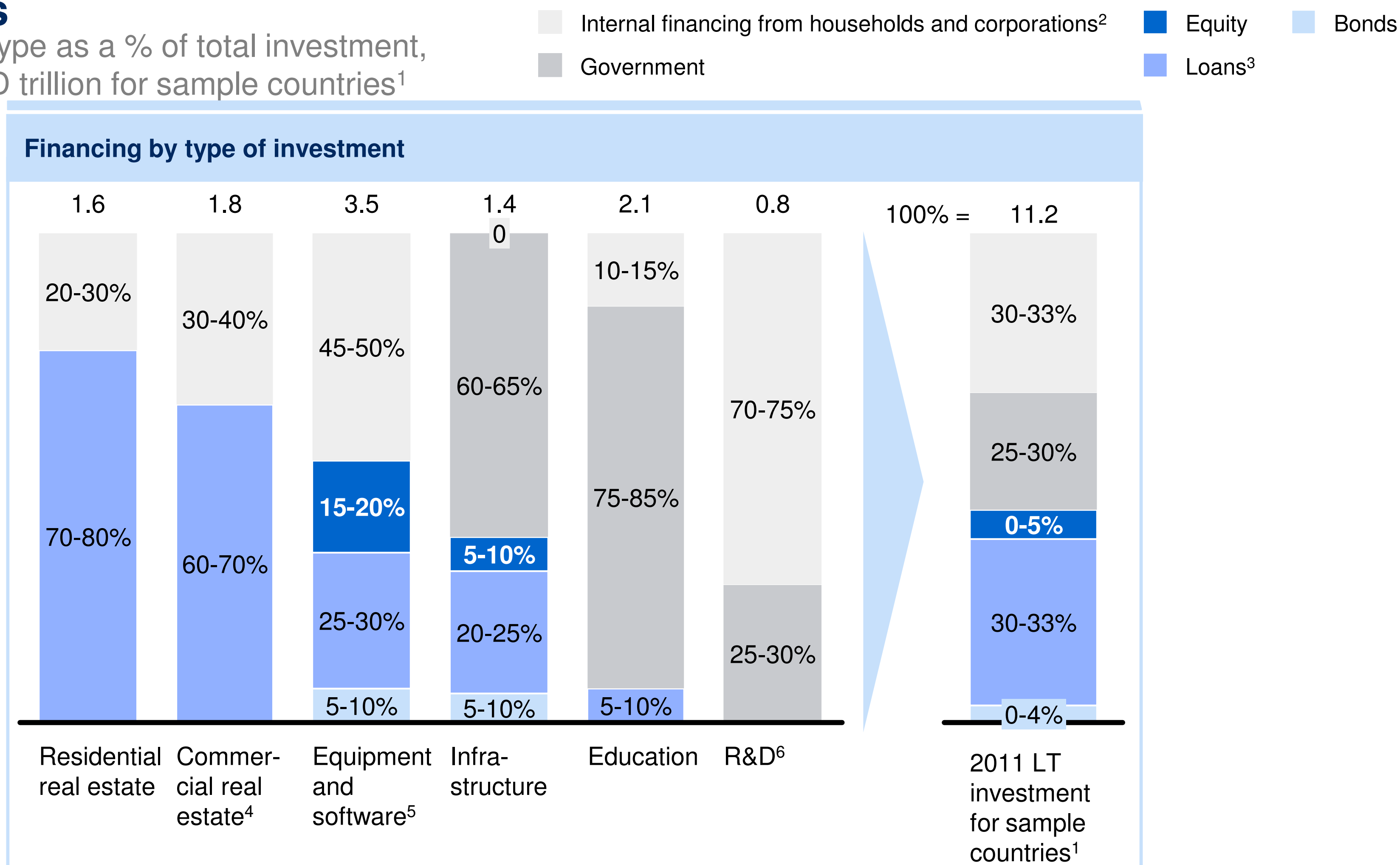


1 Figures reflect additional GDP in retail and manufacturing sectors only. Big data could also produce cost savings in government services and health care ($135 billion–$285 billion), but these do not directly translate into additional GDP.

Note: These figures are based on a partial-equilibrium analysis that estimates only first-order effects and therefore cannot be summed to calculate the full economic impact.

Roughly 40% of long-term investment is financed through equity, bonds, or loans

Financing type as a % of total investment, total in USD trillion for sample countries[1]



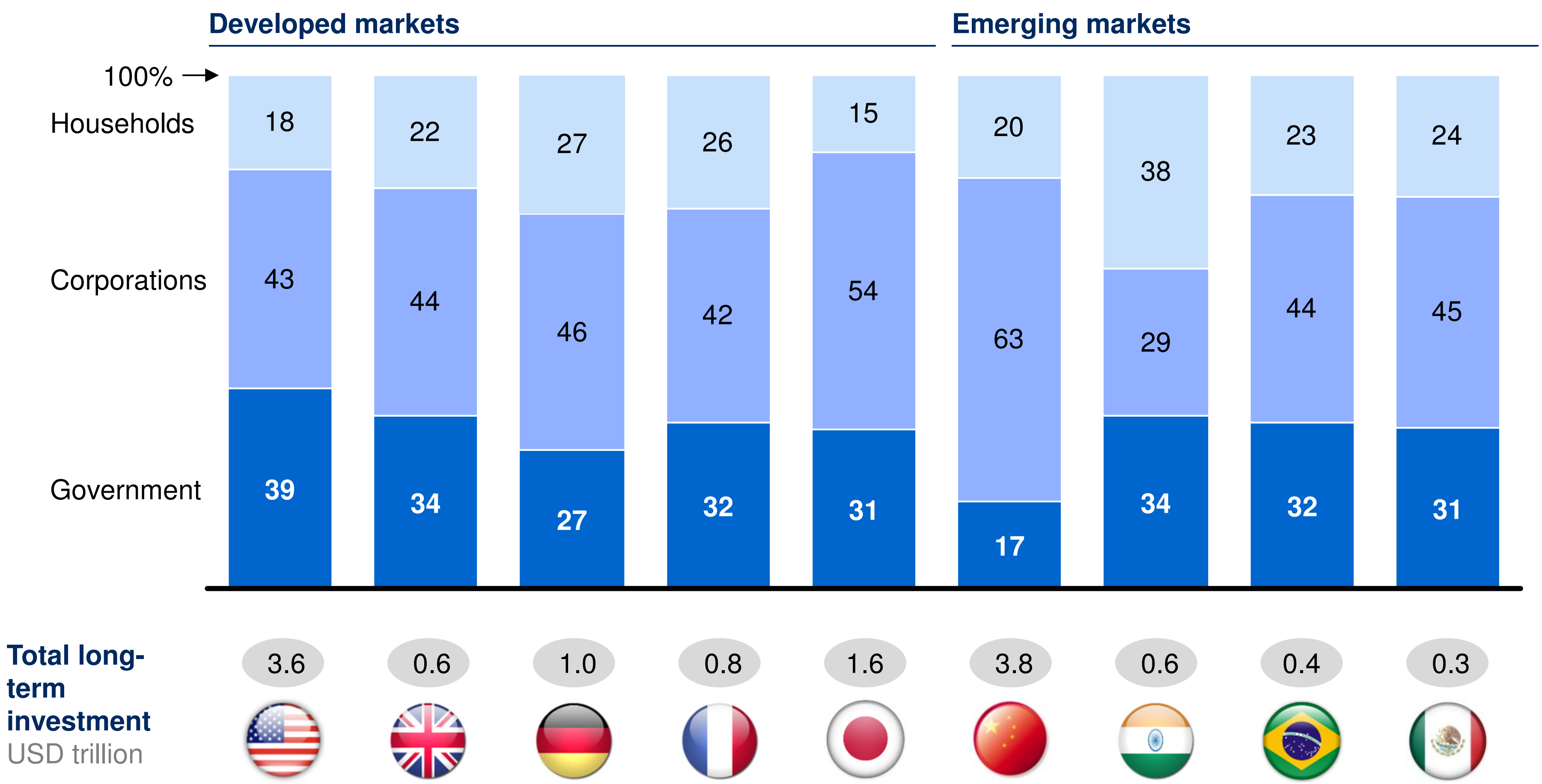
1 Estimates for a typical global project based on data from sample countries including Brazil, China, France, Germany, India, Japan, Mexico, UK, and US, representing over 60% of world GDP in 2010.
2 Internal financing here defined as financing from household income/wealth, corporations' retained earnings/cash holdings.
3 Loans for residential and commercial real estate are as originated; depending on the country, a large portion of these loans could be subsequently securitized.
4 Typical commercial real estate investment (including in existing structures) used as a proxy for investment in new commercial structures.
5 Total debt and equity financing increase as a share of capital expenditure for nonfinancial corporations across the sample of countries.
6 Research and development.

SOURCE: McKinsey Global Institute.

Government accounts for about 30% of long-term investment in most countries

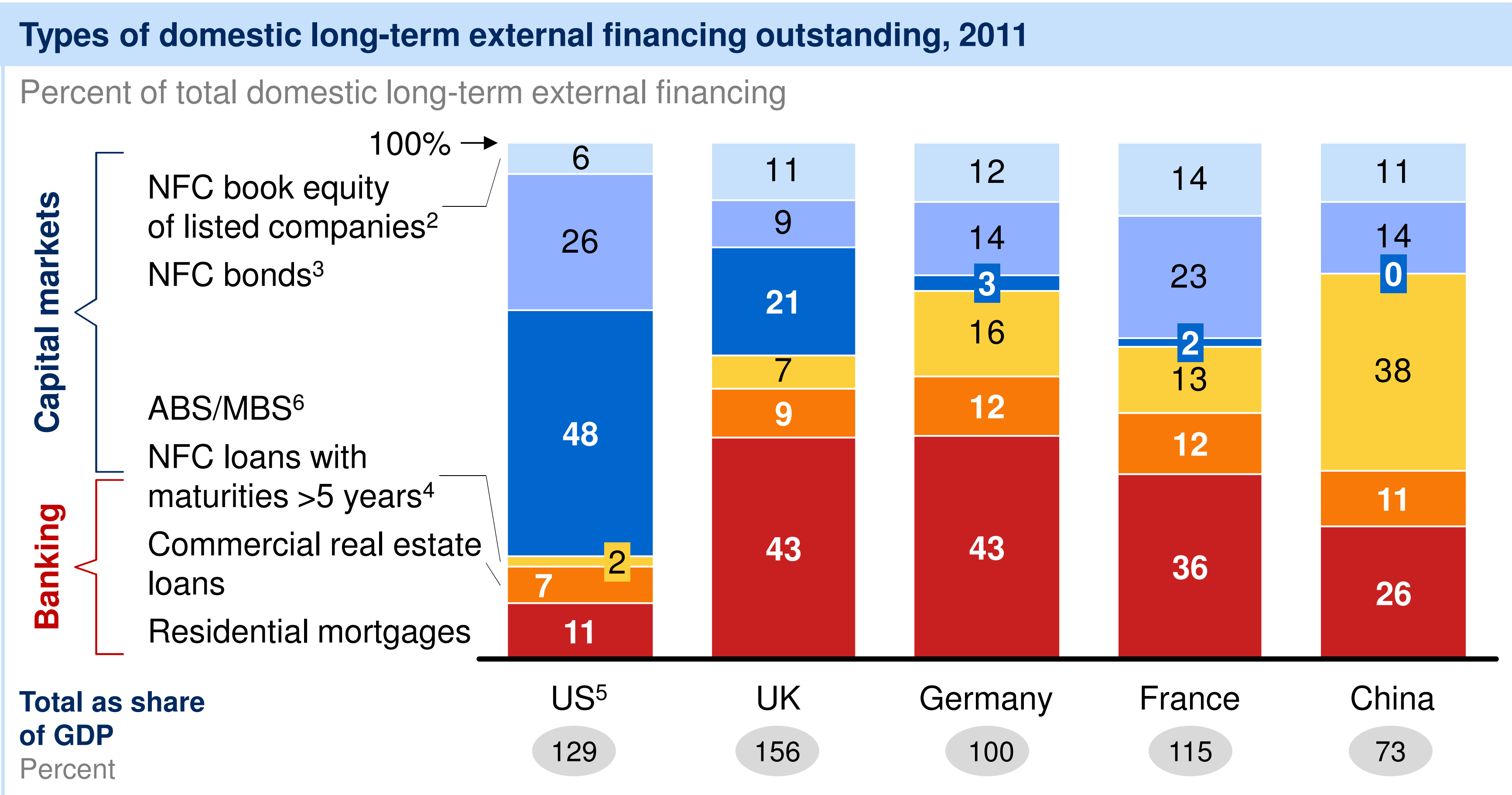
Long-term investment breakdown by sector

Percent of total long-term investment, most recent data (2011 or 2010), Country sample represents over 60% of world GDP



SOURCE: McKinsey Global Institute.

Banks provide over 50% of long-term external financing[1] outside the US, mainly through residential mortgages



1 Long-term external financing here includes NFCs' (nonfinancial corporation) book equity, nonfinancial corporation bonds, ABS/MBS (Asset-backed/mortgage-backed securities), longer maturity nonfinancial corporation loans, commercial real estate loans, and residential mortgages. Part of book equity is changes in retained earnings, which could be classified as internal.

2 Calculated by dividing total market capitalization by the average price-to-book ratio for non-financial corporations for each economy, and therefore covers only public (listed) companies. Due to data unavailability, the equity of private companies is not included.

3 Used Bank for International Settlements data for bonds outstanding to be consistent with corporate bonds data.

4 We estimate the portion of 5-year maturities using a broader set of loans.

5 US bank lending includes loans to domestic and foreign entities. The other countries only include domestic entities as counterparties.

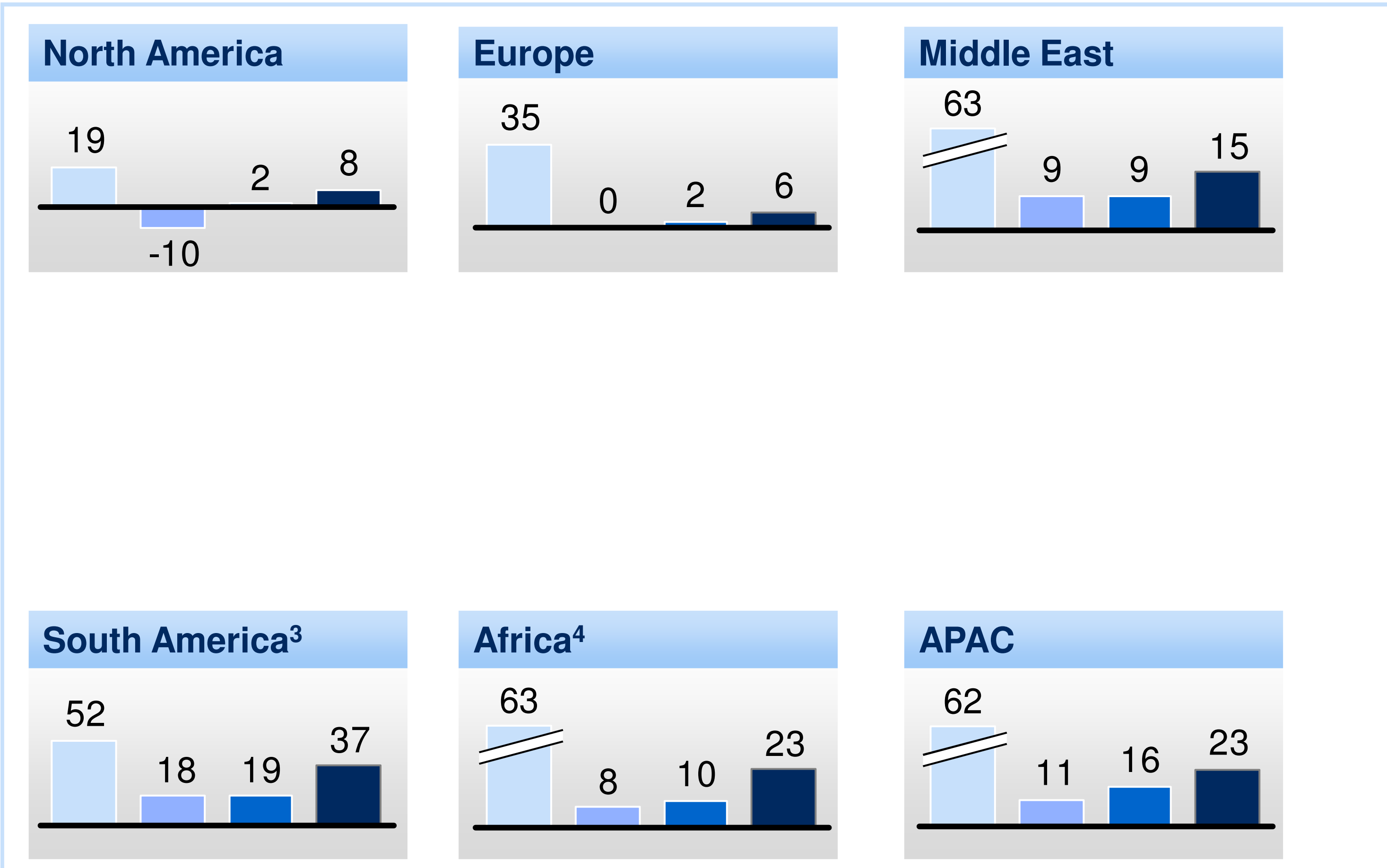
6 Asset-backed/mortgage-backed securities (ABS/MBS).

SOURCE: McKinsey Global Institute

Corporate credit is a big, solid business – but mostly lackluster in terms of growth and profitability

2009 – 2011, in %

Corporate credit[1] as a share of total lending | Volume CAGR | Corporate credit ROE[2] | Classical Corporate Banking ROE[2,5]

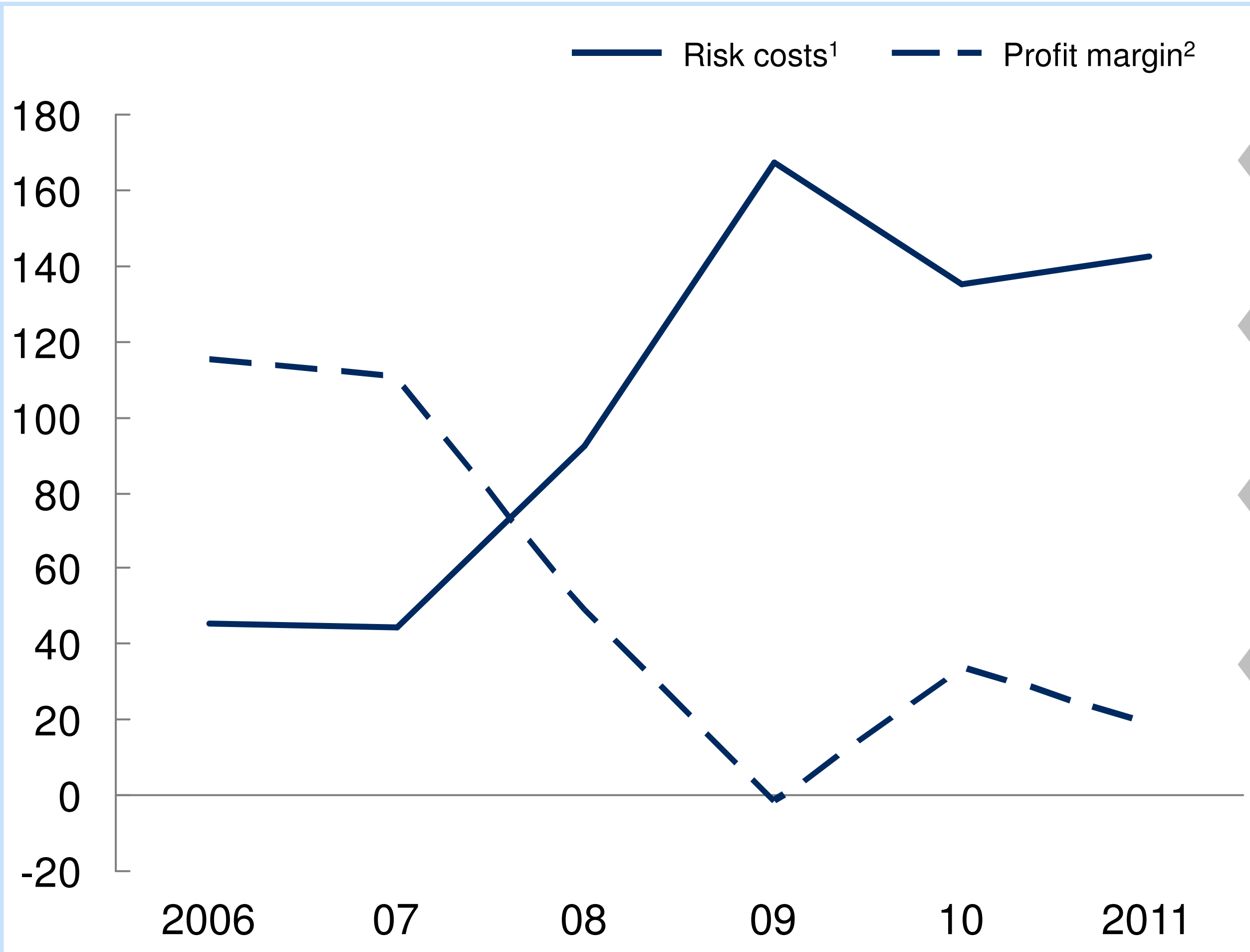


1 Average share of corporate credit business compared to total lending volumes (retail, public sector and non-banking financial institutions)
2 After risk costs, assuming 90% risk weighting, 10% capital requirements and pre-tax
3 Including Mexico
4 Rough estimates, only includes corporate and retail lending due to data availability
5 Includes the following products: cash management and financing; excludes CMIB business of corporates

SOURCE: McKinsey Global Banking Pools; McKinsey estimate

Financial crisis has further strongly affected corporate credit business and led to a massive decrease in banking profits

Europe (Western and CEE), in bps



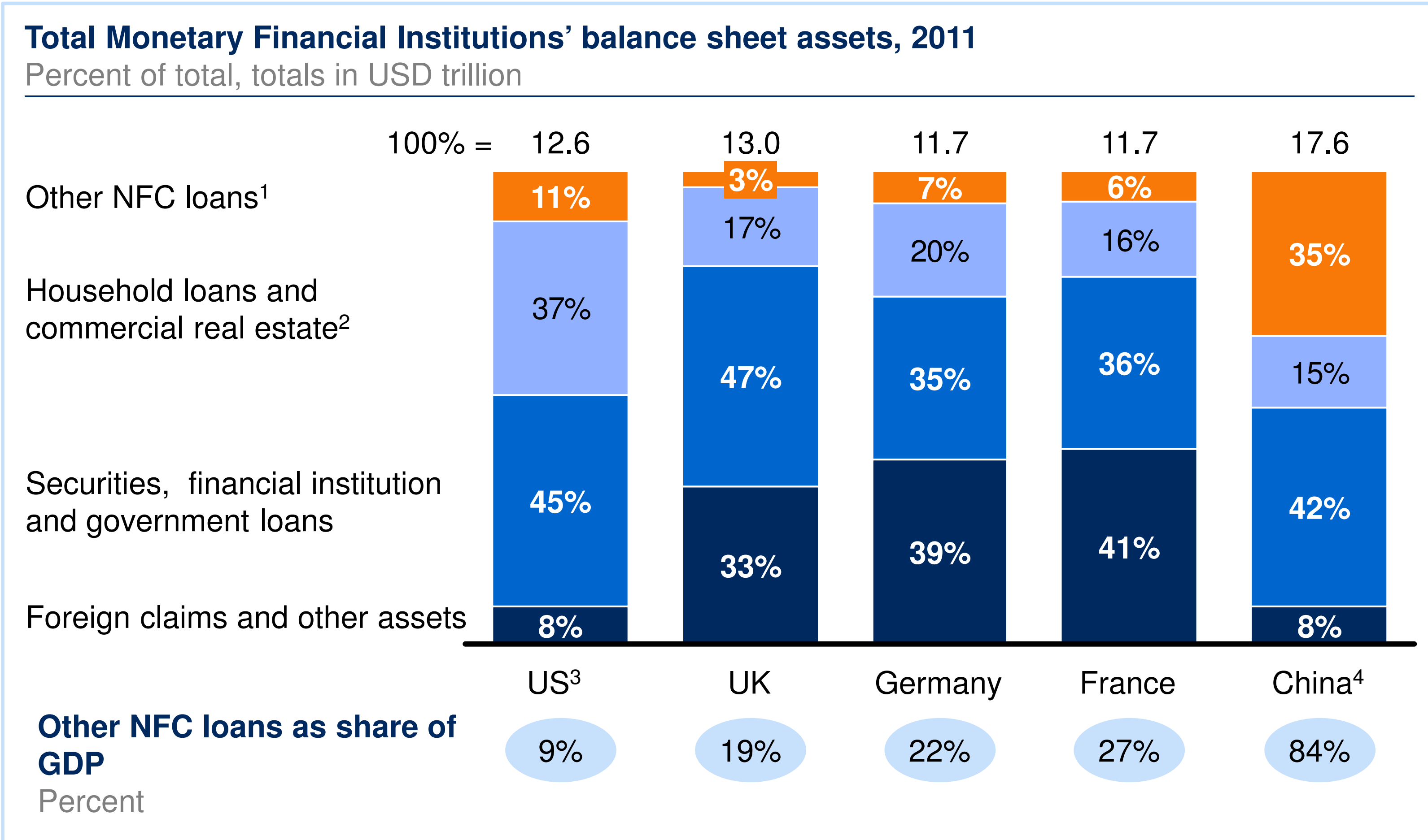
Key drivers affecting corporate credit profitability

- Limited growth in most countries
- Higher capital and funding charges
- Increased risk costs and volatility
- Significant reduction in placement channels

1 Actual risk costs calculated (EL = PD * EAD * LGD); divided by lending volumes
2 Pre-tax profit from corporate lending; divided by lending volumes

SOURCE: McKinsey Global Banking Pools

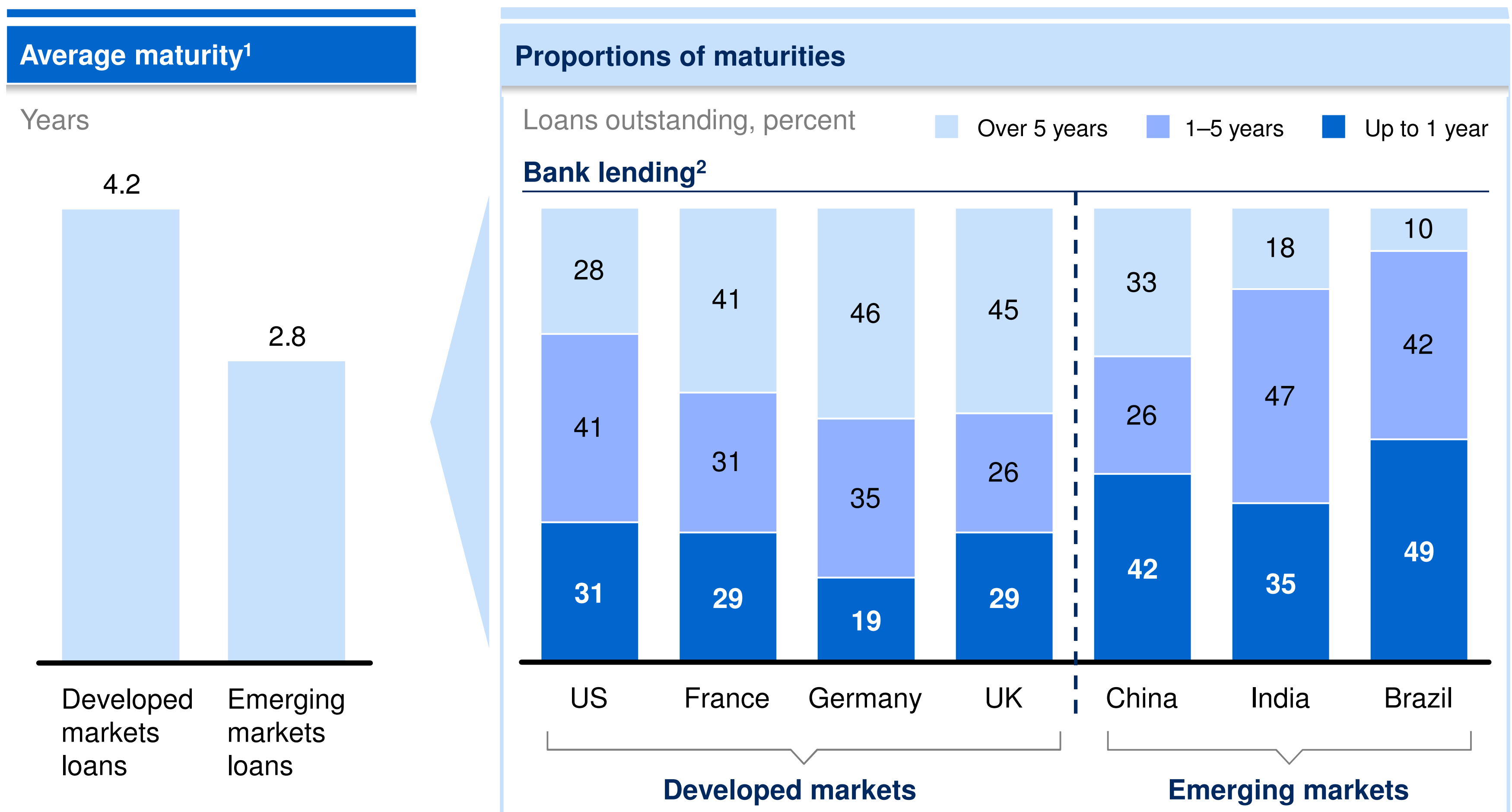
However, as a share of total bank assets, lending to NFCs other than for real estate is small, at less than 10% in developed economies



1 Other NFC (nonfinancial corporation) loans include all nonfinancial corporation loans outstanding except for loans to commercial real estate sectors.
2 Includes loans to households (including mortgages and consumer credit) and loans outstanding to commercial real estate sectors.
3 The US balance sheets do not provide the domestic/foreign asset distinction. Foreign claims are claims on all counterparties outside of the country.
4 The data set for China covers banks and finance companies (excluding Peoples Bank of China). China does not provide details on securities as opposed to loans (and advances), so the loan category includes securities to corresponding counterparties.

SOURCE: McKinsey Global Institute.

Bank lending is typically short-term, especially in emerging markets

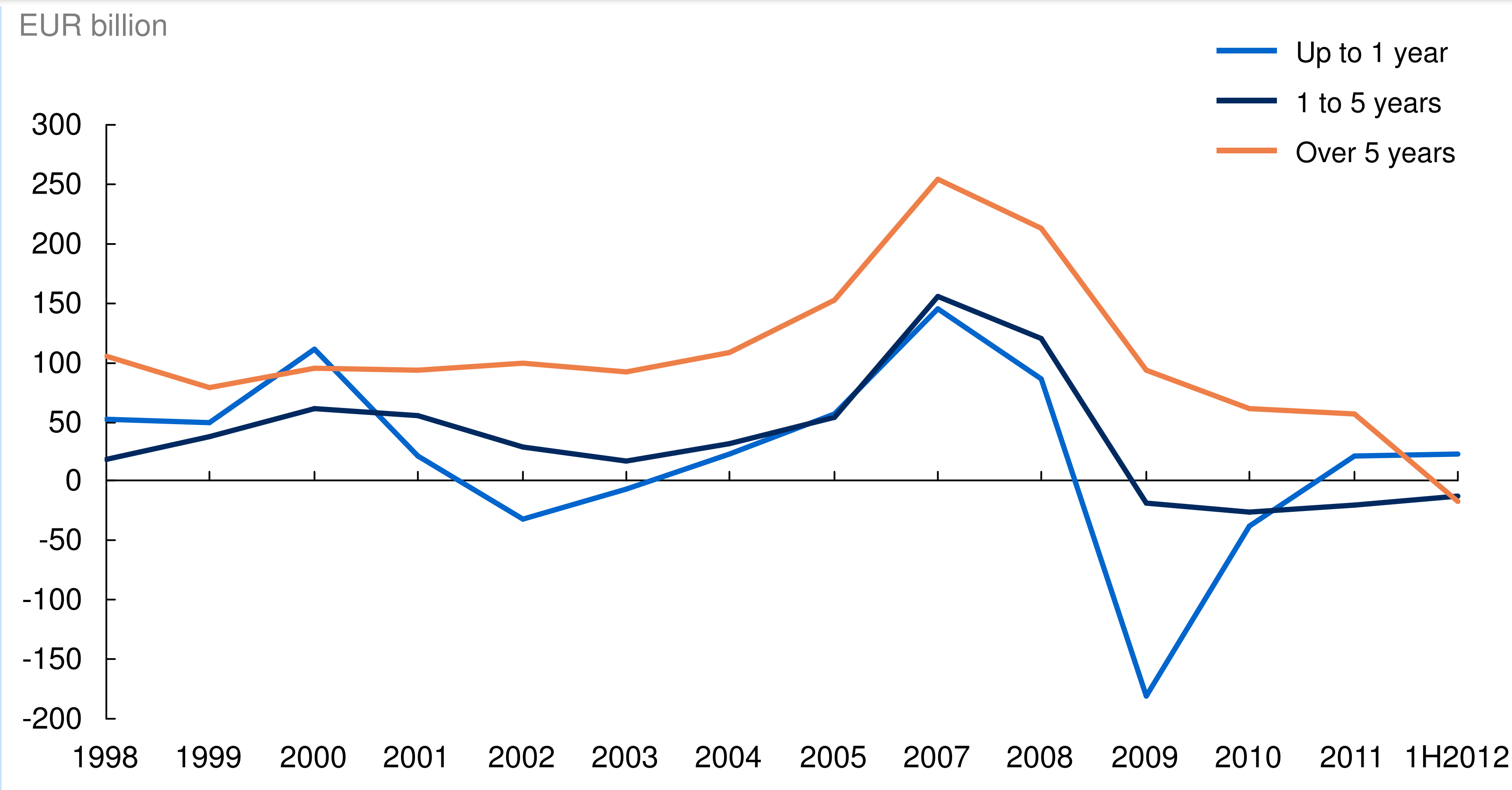


1 Calculated using the countries and weights from the chart on the right, using 0.5, 2.5, and 8 years as average maturities for each category.
2 Bottom-up analysis of banks' balance sheets for banks representing at least 70% of the total market share in each country, except for China and India (top 10 banks used for both) and European countries (all domestic banks with assets above USD 5 billion used).

SOURCE: McKinsey Global Institute.

In the Eurozone, all net new bank lending to nonfinancial corporations is for maturities of 1 year or less

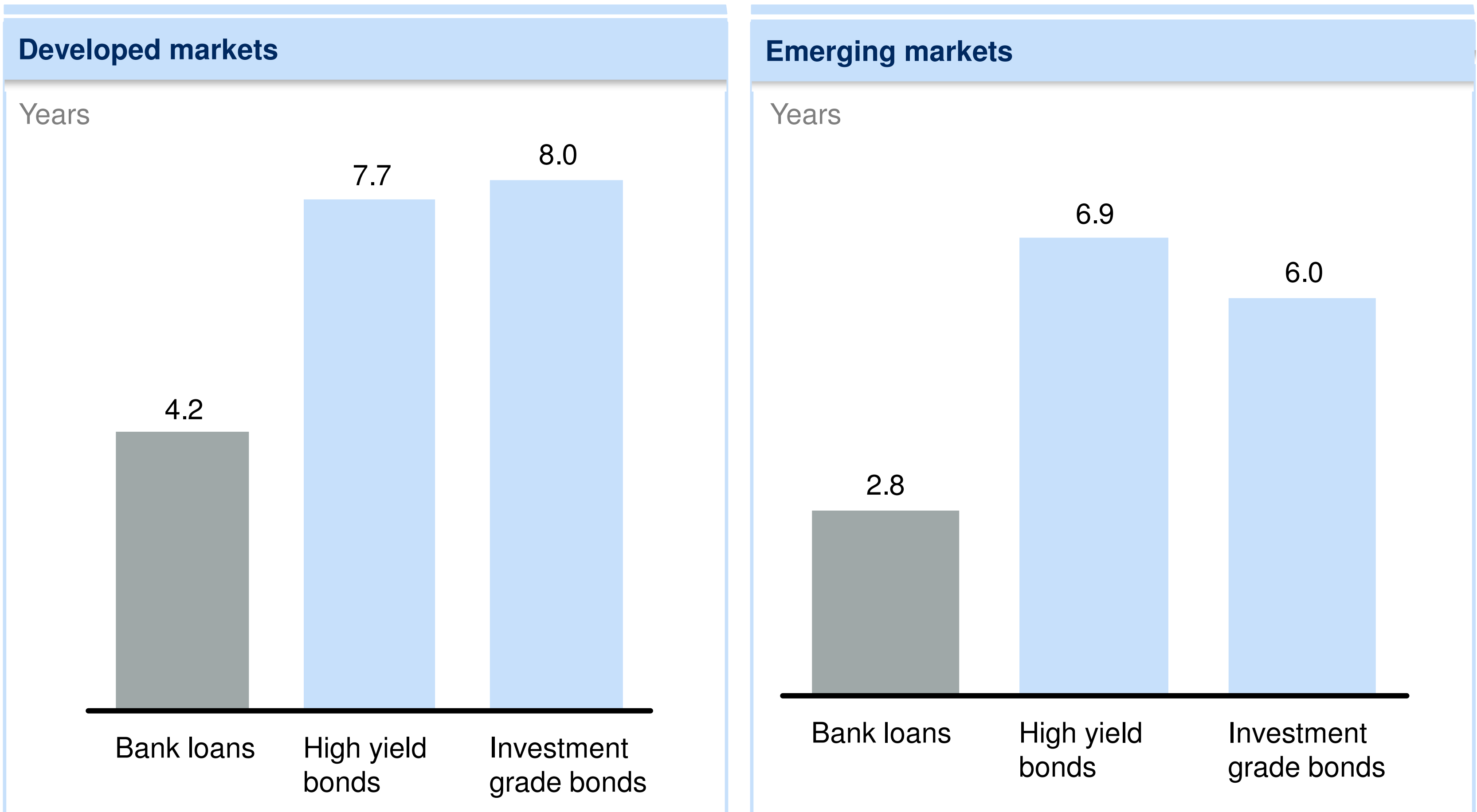
Euro area annual net new lending to nonfinancial corporations



SOURCES: European Central Bank; McKinsey Global Institute.

Corporate bonds have significantly longer maturities than bank loans in both developed and emerging markets

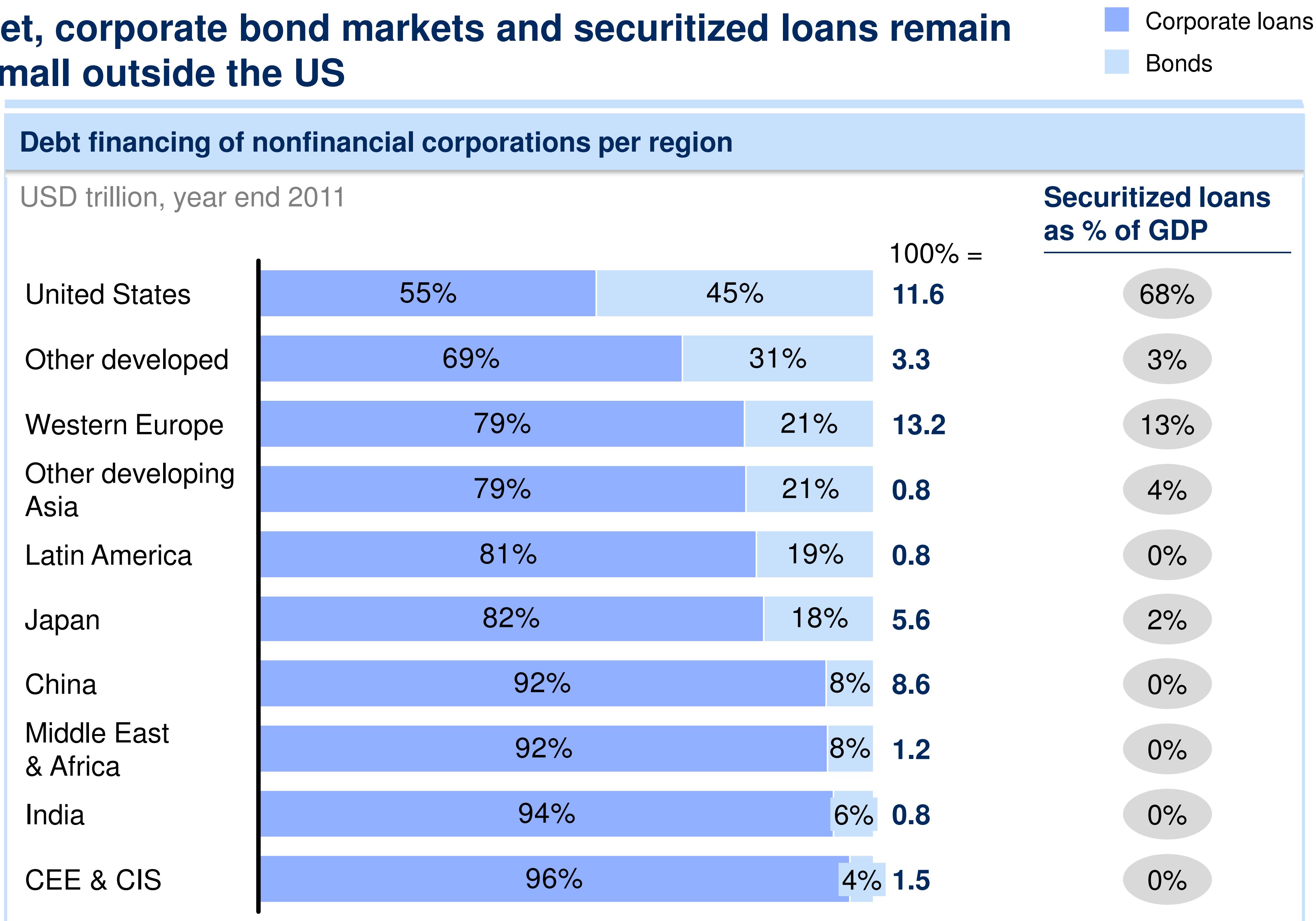
Average maturity of financial instrument[1]



1 Based on 3-year weighted average of maturity from sample countries (France, Germany, UK, US for developed markets; Brazil, China, India for emerging markets).

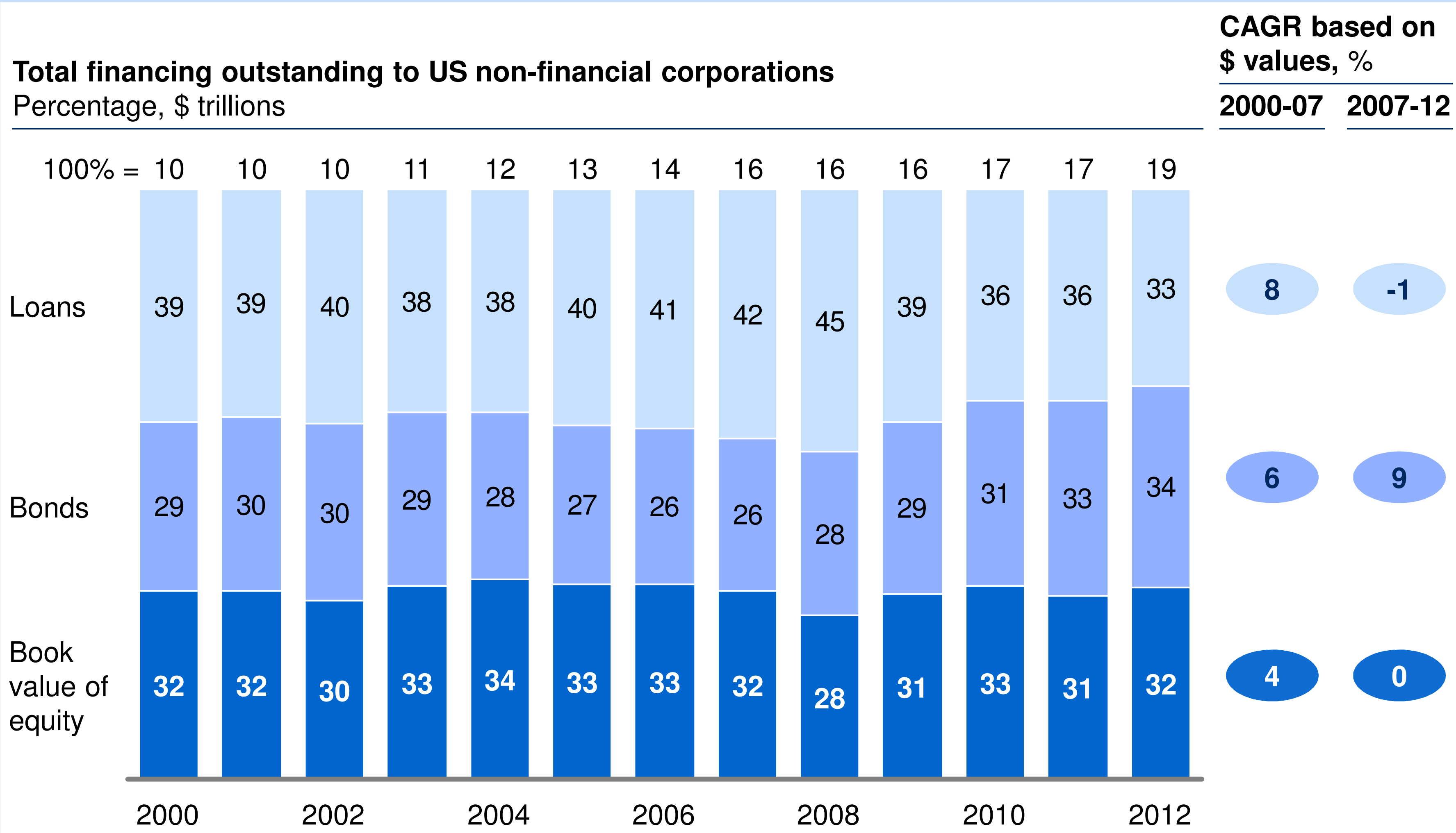
SOURCE: McKinsey Global Institute.

Yet, corporate bond markets and securitized loans remain small outside the US



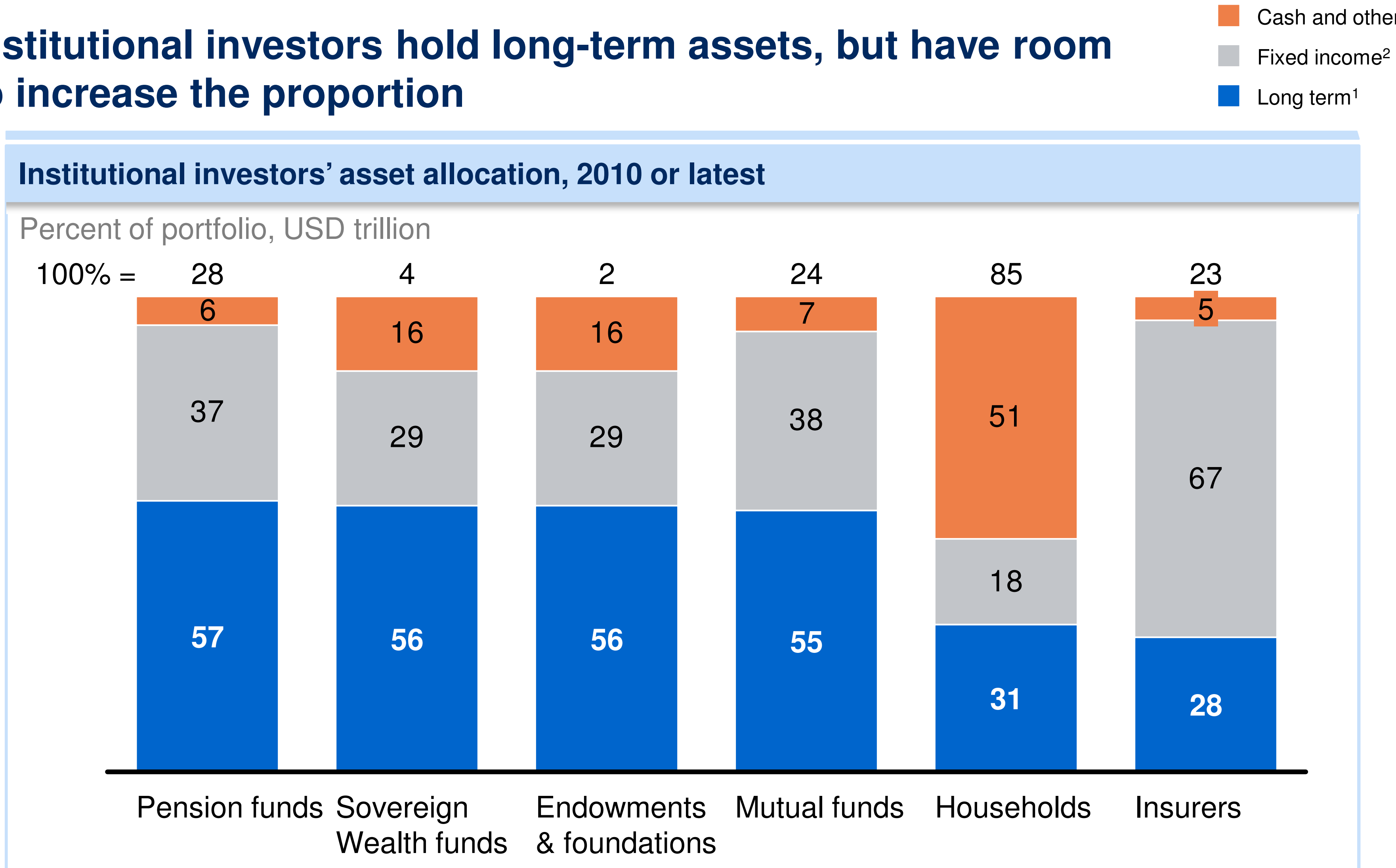
SOURCE: McKinsey Global Institute Financial Stock Database 2012, McKinsey Global Institute analysis.

Despite ongoing discussions on its sustainability, the US financing model was confirmed after the crisis



SOURCE: McKinsey Global Institute Financial Assets database; US Federal Reserve; CPAT; S&P; McKinsey Global Institute analysis

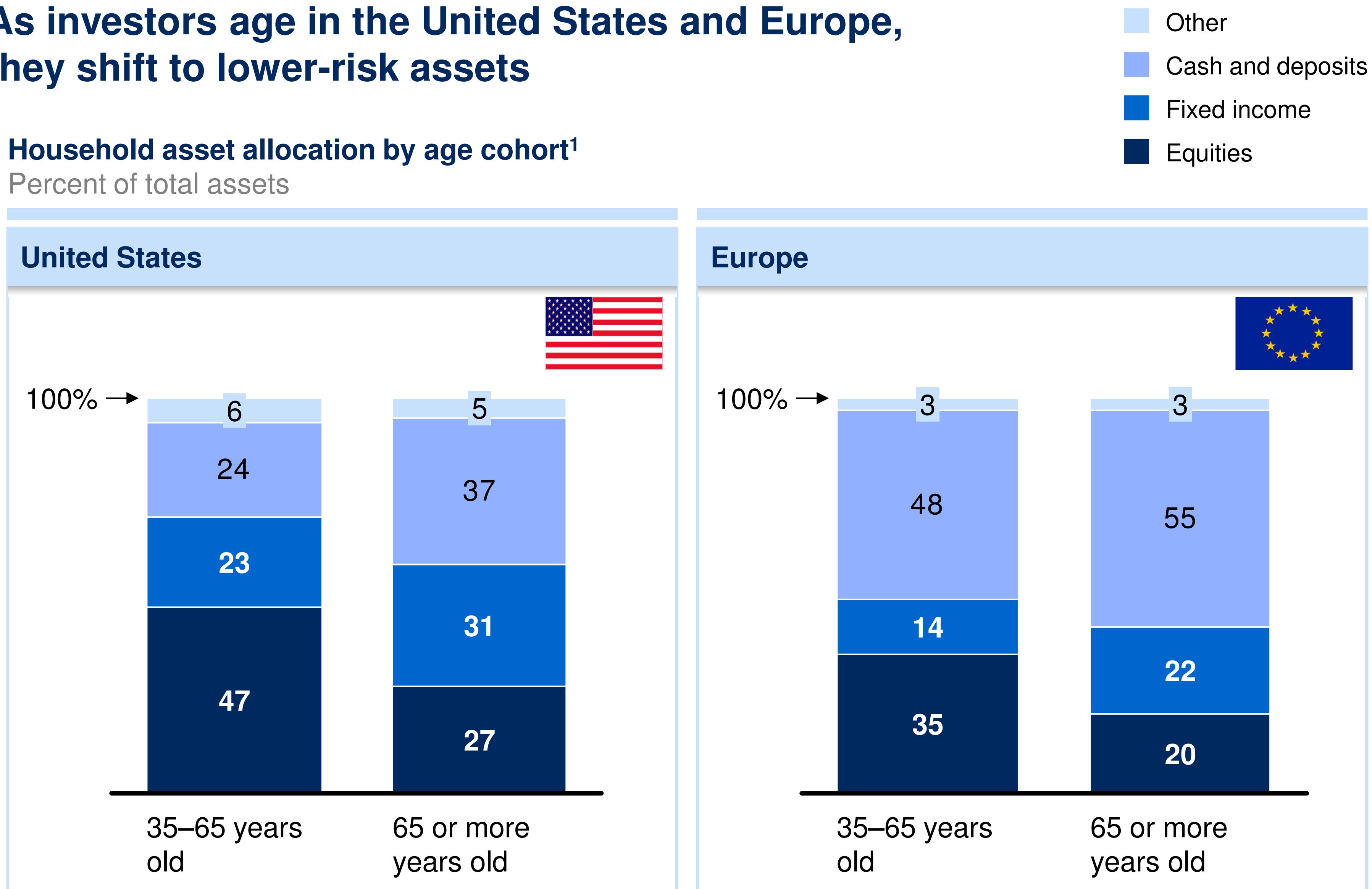
Institutional investors hold long-term assets, but have room to increase the proportion



1 Long term investment defined as equities and 80% of alternative assets; cash and other includes cash and 20% of alternative assets.
2 Fixed income includes some risky long-term investment, such as corporate bonds, but the data is unavailable for a further breakdown.

SOURCE: McKinsey Global Institute, "The emerging equity gap: Growth and stability in the new investor landscape" (December 2011).

As investors age in the United States and Europe, they shift to lower-risk assets

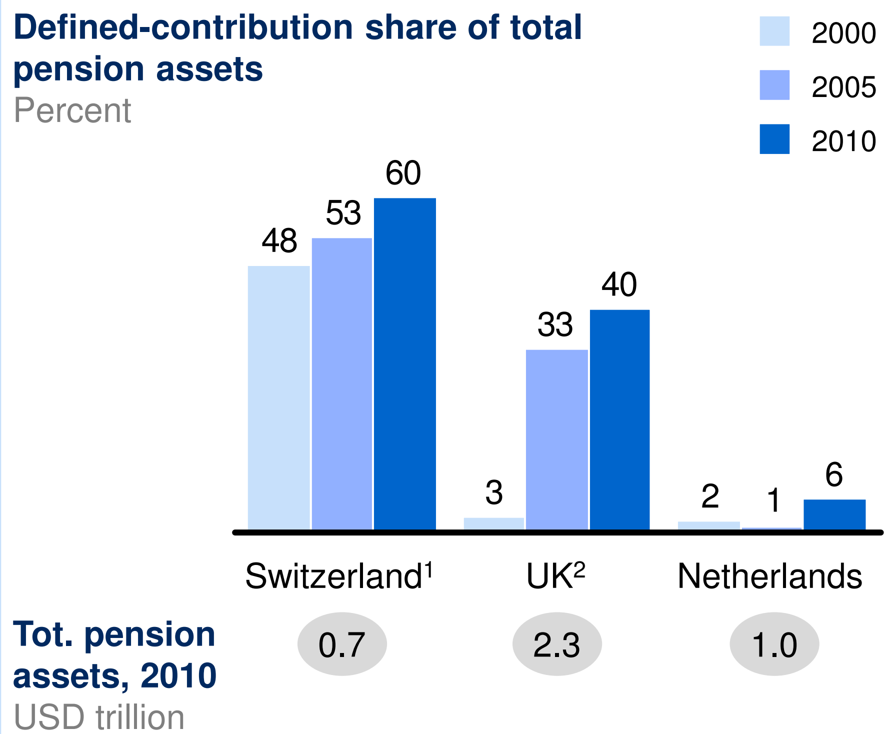


1 Excludes retirement assets.

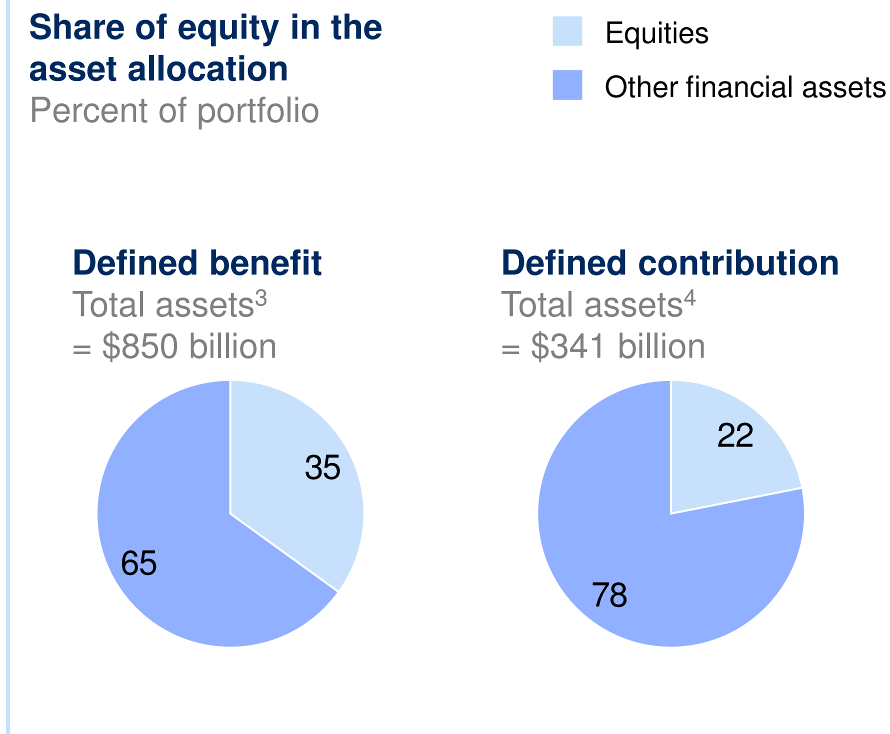
SOURCE: McKinsey Global Institute, "The Emerging Equity Gap: Growth and Stability in the New Investor Landscape" (December 2011).

The rise of defined-contribution pension plans in Europe will lead to a further shift out of equity

The share of defined-contribution pension plans has been increasing in Europe



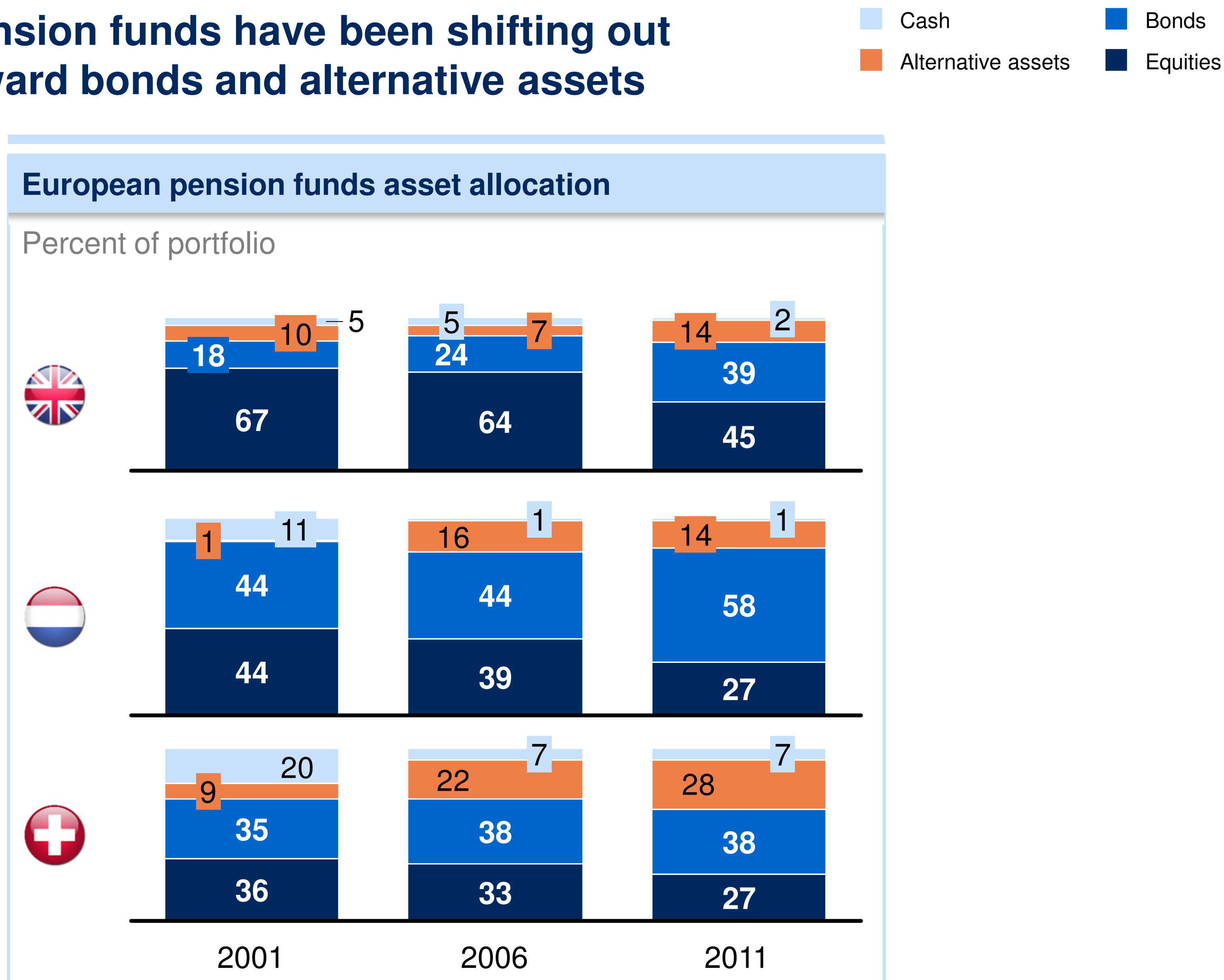
Defined-contribution plans allocate less to equity than defined-benefit plans



1 In Switzerland, defined-contribution stands for funds where the plan sponsor shares the investment risk and all assets are pooled. There are almost no pure defined-contribution assets where members make an investment choice and receive market returns on their funds.
2 UK data do not include personal and stakeholder assets but do include insurance-administered vehicles. If the latter were excluded as well, the proportion of defined-contribution assets would fall to 25%.
3 Allocation based on a sample of the following plans: ABP, PFZW, ATP, Alecta, Royal Dutch Shell, Universities Superannuation, FRR, and Varma.
4 Allocation based on a sample of the following plans: Bayerische Versorgungskammer, BT Group, PFA Pension, Royal Mail, Royal Bank of Scotland Group, Ilmarinen, British Coal Pension Schemes, and Barclays Bank UK.

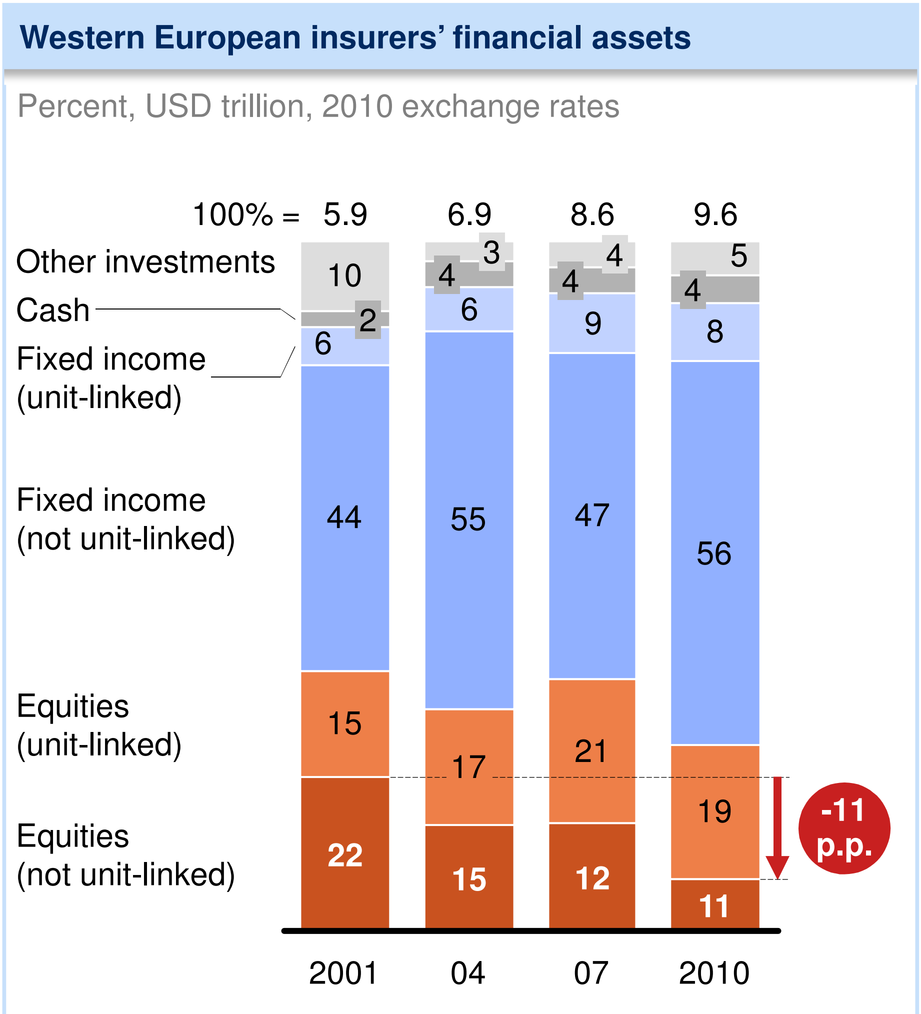
SOURCE: McKinsey Global Institute, “The Emerging Equity Gap: Growth and Stability in the New Investor Landscape” (December 2011).

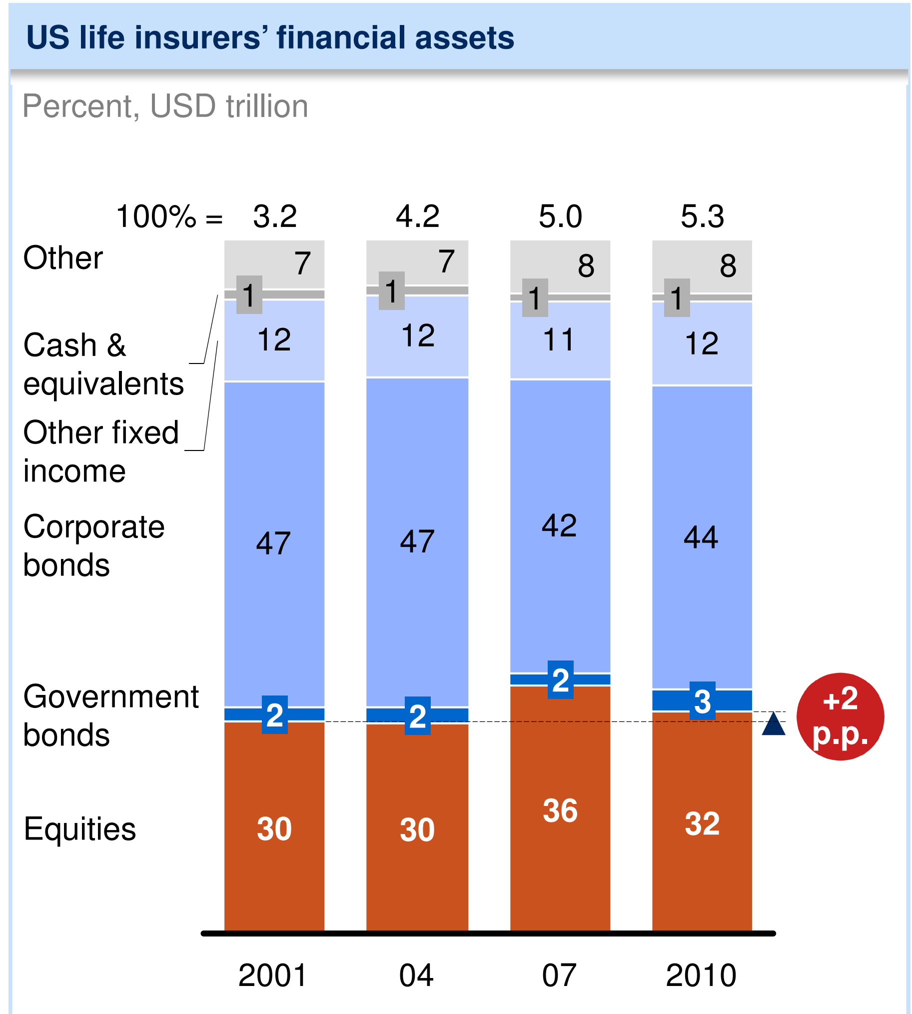
European pension funds have been shifting out of equity, toward bonds and alternative assets



SOURCE: McKinsey Global Institute, “The Emerging Equity Gap: Growth and Stability in the New Investor Landscape” (December 2011).

European insurers have been decreasing their allocation to equities outside their unit-linked businesses since 2001, in contrast to US insurers





NOTE: Numbers may not sum due to rounding.

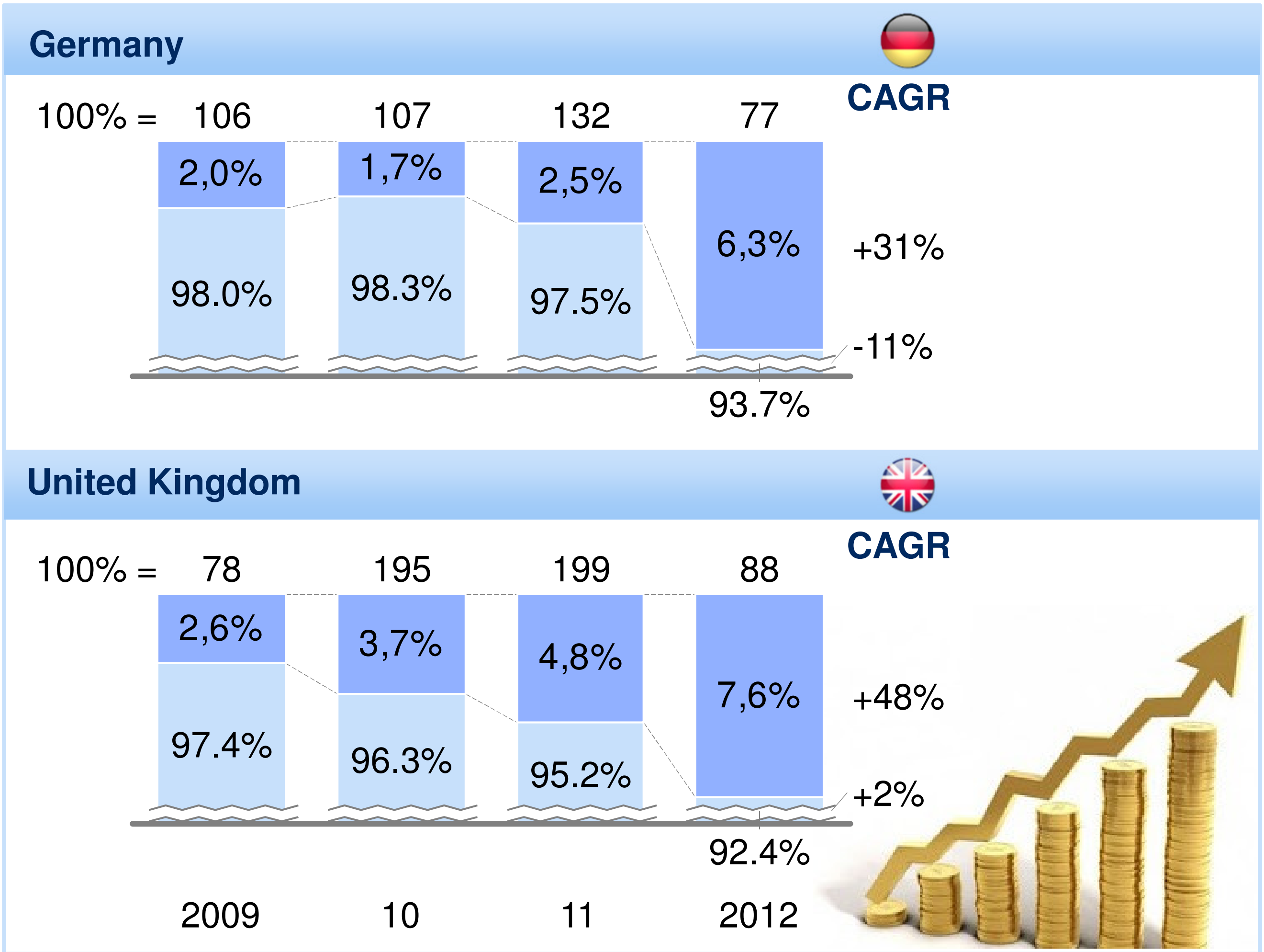
SOURCE: McKinsey Global Institute, "The Emerging Equity Gap: Growth and Stability in the New Investor Landscape" (December 2011).

Insurance companies and other non-bank investors have significantly increased their engagements in structured finance

EXAMPLE

Deal values of syndicated loans, bn USD

Non-bank Bank

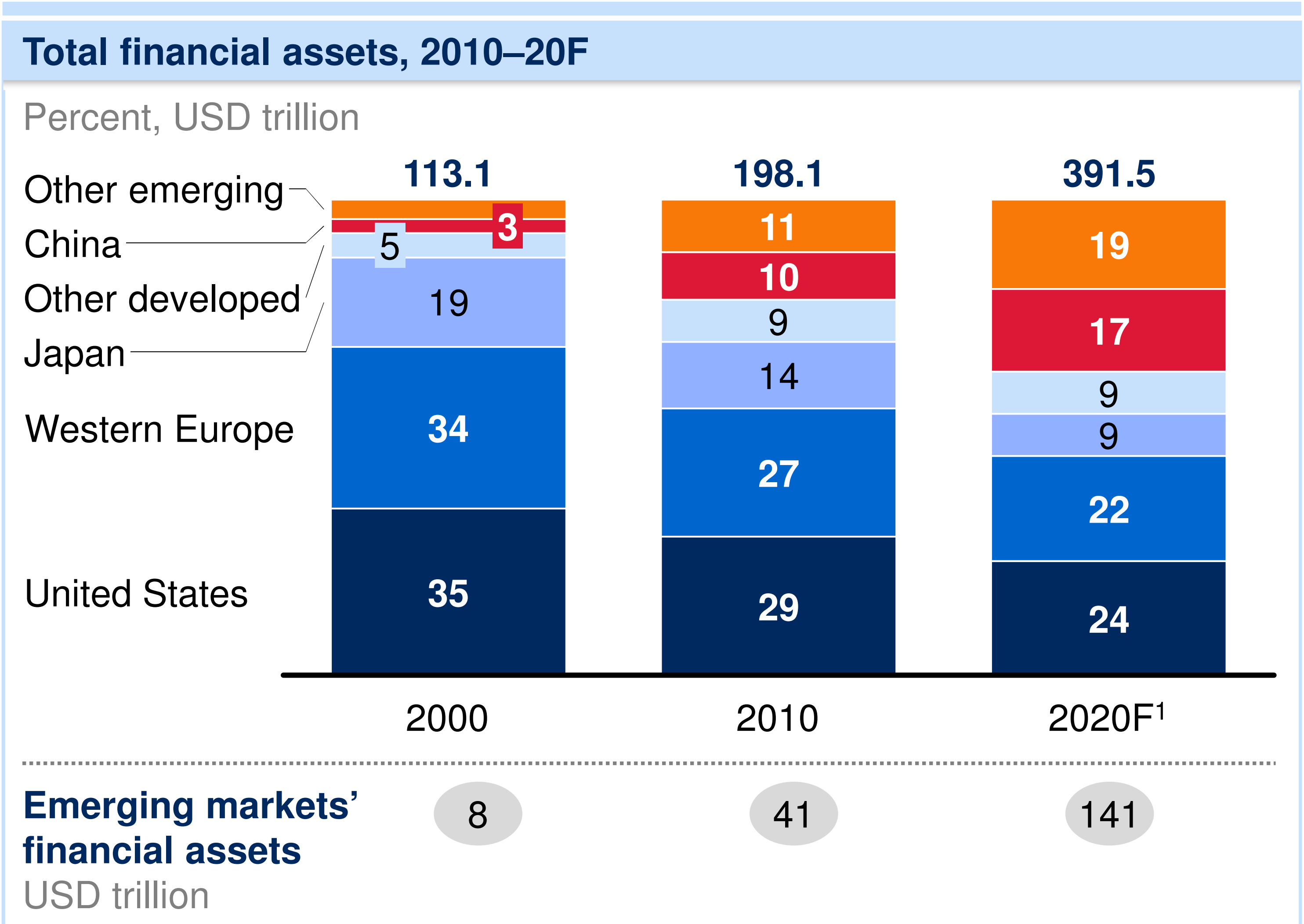


- Different non-banking players have significantly increased their participation in syndicated lending deals
- The number of acting institutions[1] is still limited but expected to increase severely
- A lot of non-bank activity is already taking place in the bilateral space and is also likely to grow

1 Top 3 players among insurance companies engaged in Germany are Allianz, Massachusetts Mutual Life and Zurich

SOURCE: Dealogic; McKinsey

Due to high savings and fast GDP growth, emerging markets' share of financial assets is projected to nearly double by 2020



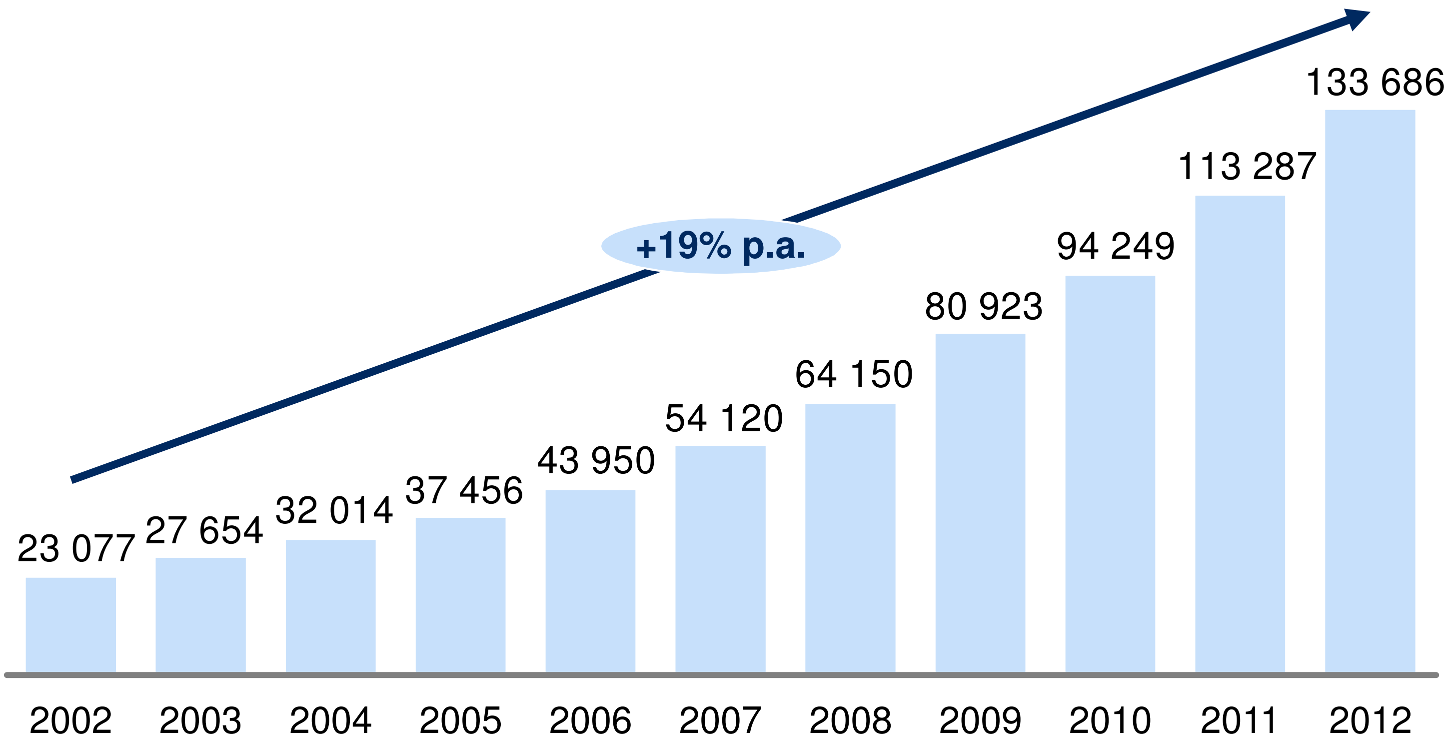
1 Assumes consensus GDP forecasts for individual countries and that emerging markets' currencies appreciate vis-à-vis the US dollar.

SOURCE: McKinsey Global Institute, "The Emerging Equity Gap: Growth and Stability in the New Investor Landscape" (December 2011).

Illustration: The banking sector in China is expanding steadily

Banking asset

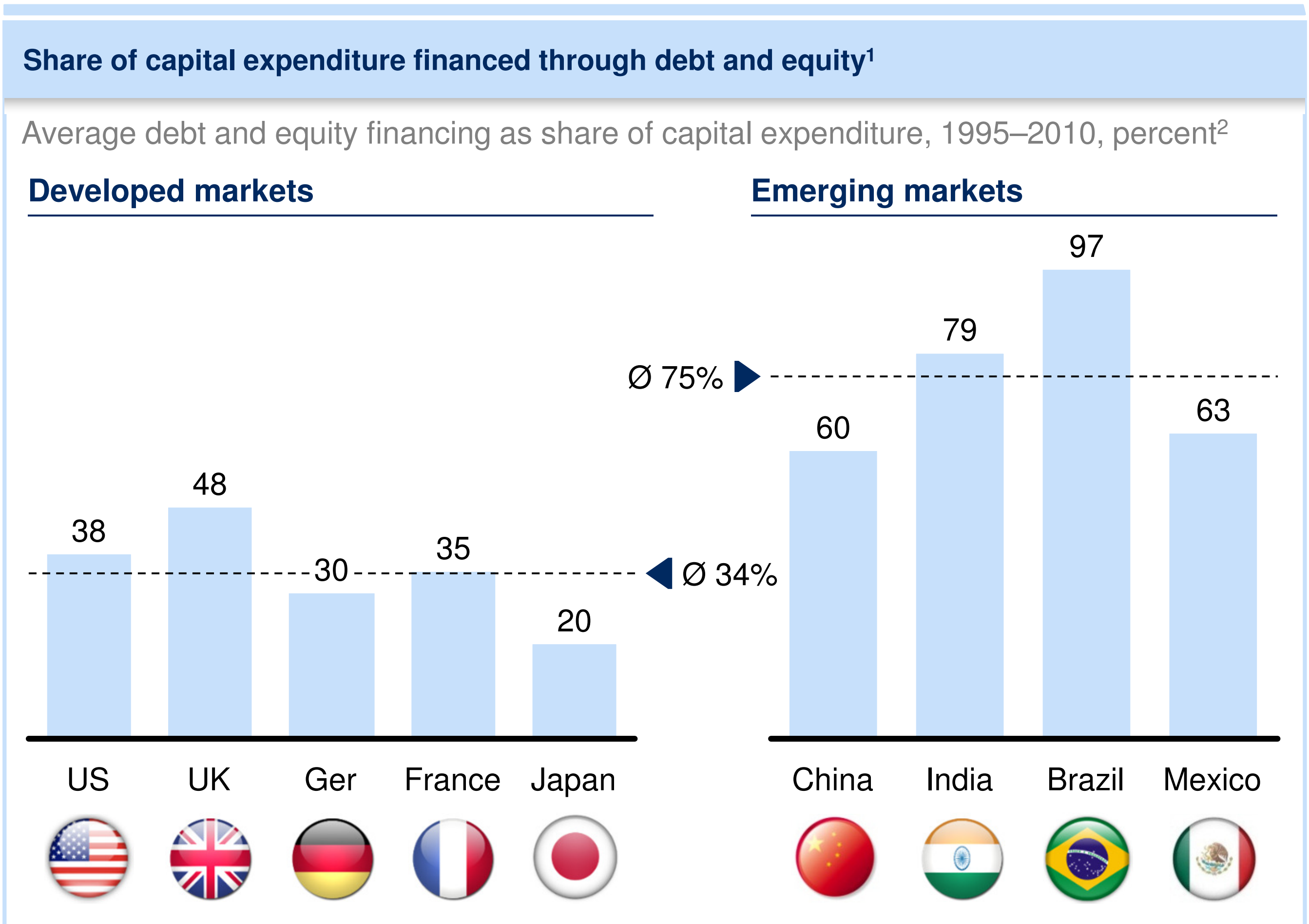
RMB billions



1 Refer to real GDP growth rate

SOURCE: PBOC; NBSC

In the corporate sector, investment is mainly financed through retained earnings in developed markets and debt and equity in emerging markets



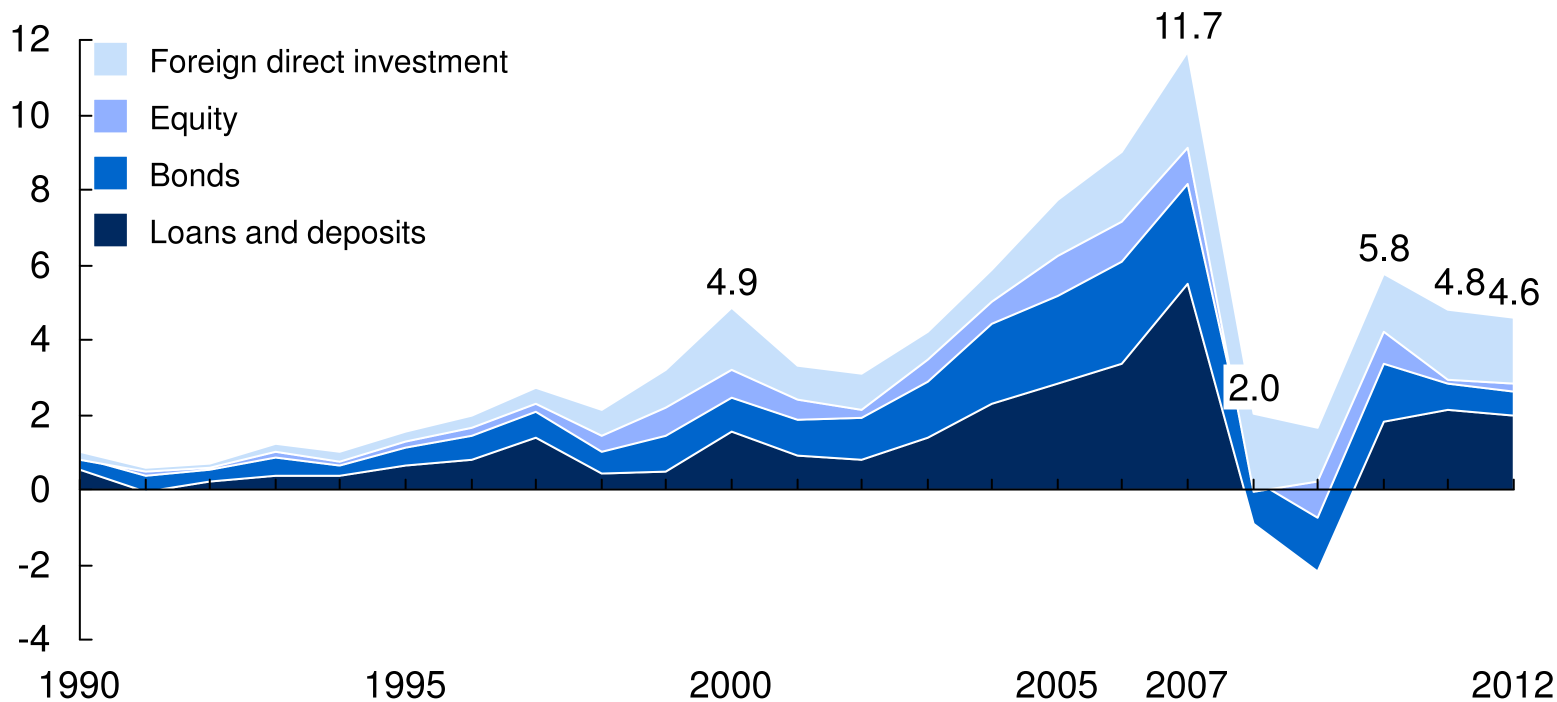
1 Total annual change in debt and equity financing as % of capital expenditure used to proxy share of external financing for largest public nonfinancial corporations by market share; capital expenditure includes corporate investment in tangible assets and does not include R&D or education.
2 For Mexico, only 97 companies are available; for Brazil, China, France, and Mexico, 2001–2010 average used due to lack of data for previous years.

SOURCE: McKinsey Corporate Performance Analysis Tool, McKinsey Global Institute analysis.

Having driven a substantial portion of flows from 2000 to 2007, cross-border loans dramatically fell away during the crisis

Total cross-border capital inflows[1], 1980–2011

USD trillions, constant 2011 exchange rates

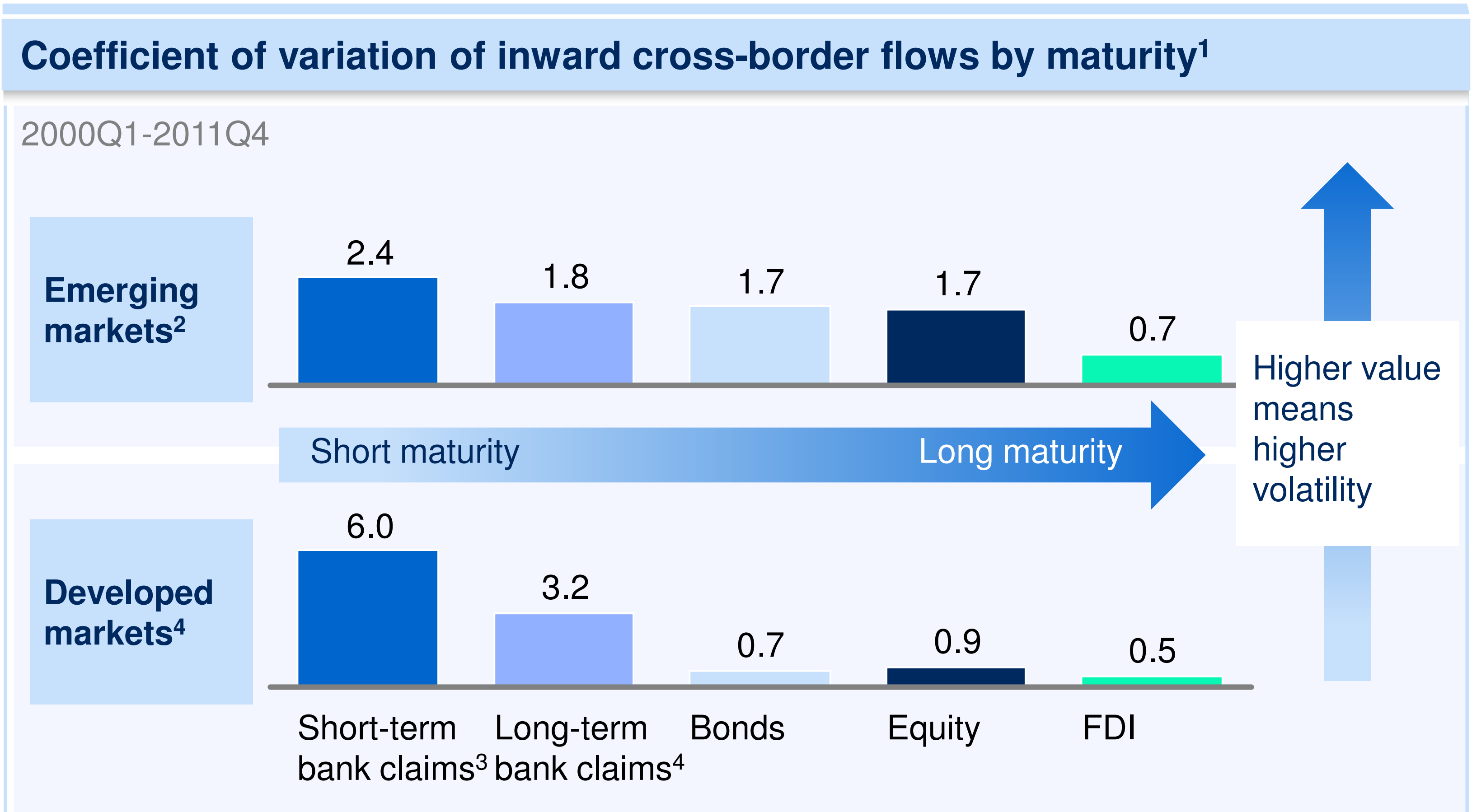


Percent global GDP	1990	1995	2000	2005	2007	2012
	5	5	13	15	21	6

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

SOURCE: International Monetary Fund, McKinsey Global Institute.

Across both emerging and developed economies, cross-border bank claims have been more volatile than bond and equity flows



1 Coefficient of variation defined as standard deviation normalized by the mean; calculations are made on quarterly data.
2 Sample includes 29 developed markets and 120 emerging markets.
3 Bank net acquisition of cross-border loans and other debt assets in emerging and developed economies, with maturity less than or equal to two years.
4 Bank net acquisition of cross-border loans and other debt assets in emerging and developed economies, with maturity more than two years.

SOURCE: Bank for International Settlements, International Monetary Fund, McKinsey Global Institute.

Since 2007, Eurozone banks have reduced foreign claims by $3.9 trillion, $2.9 trillion of which was intra-European…

Consolidated foreign claims of Eurozone reporting banks (includes loans and other foreign financial assets)[1]

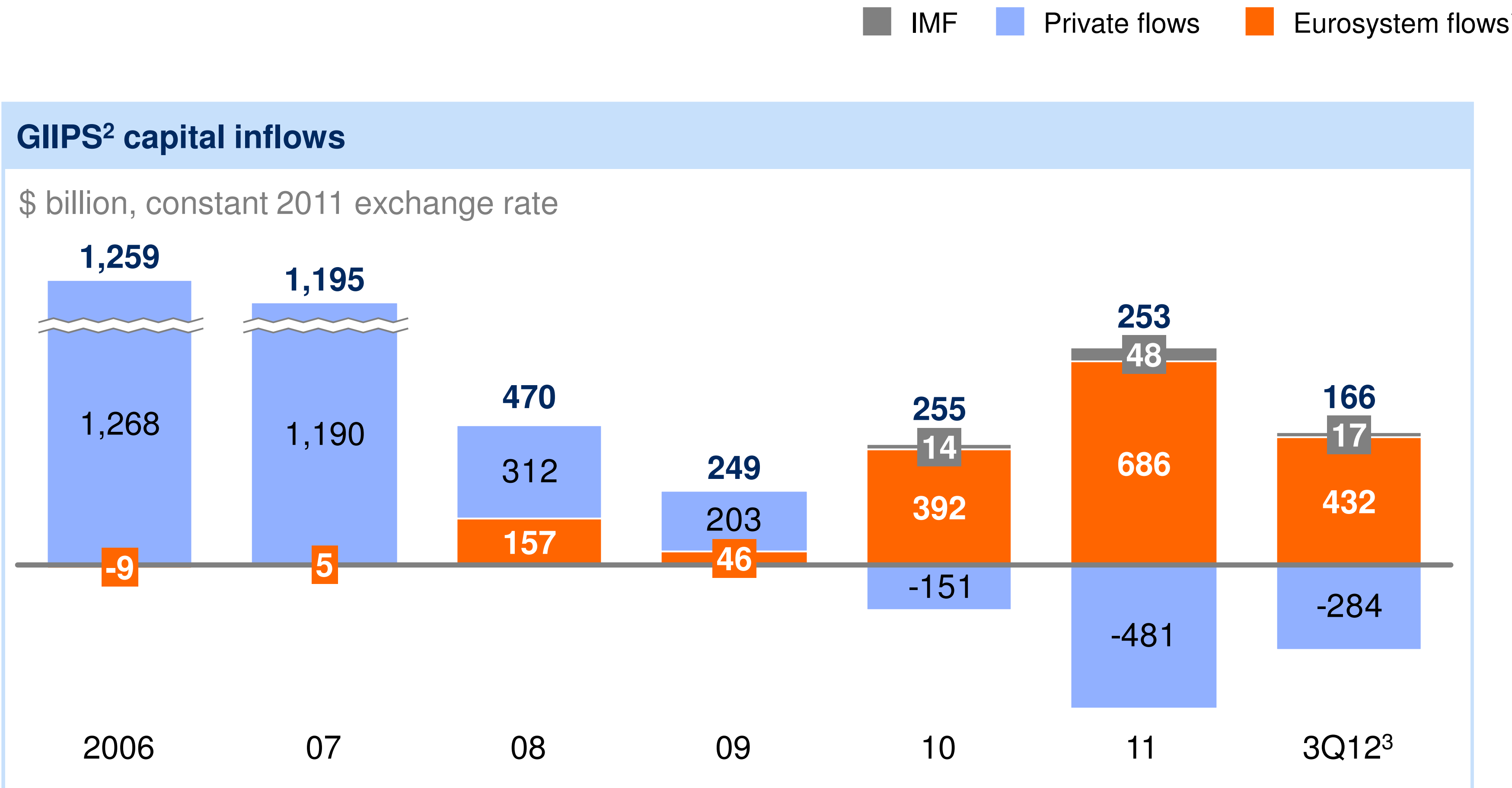
By counterparty location, constant 2011 exchange rates

	Change			
	4Q99–4Q07		4Q07–1Q13	
Eurozone bank claims on:	$ billion	Compound annual growth rate (%)	$ billion	Compound annual growth rate (%)
GIIPS[2]	1,729	17	-1,183	-12
Other Eurozone	2,025	12	-681	-4
United Kingdom	1,609	16	-944	-9
Other Western Europe	304	12	-133	-6
Total Western Europe	5,668		-2,941	
United States	1,382	13	-822	-8
Other developed	509	6	-422	-7
Developing countries	1,182	13	317	3
Total	**8,737**		**-3,866**	

1 Includes banks from Austria, Belgium, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Portugal, and Spain.
2 GIIPS comprises Greece, Ireland, Italy, Portugal, and Spain.

SOURCE: Bank for International Settlements; McKinsey Global Institute analysis

… Fueling a Euro-crisis that was only halted by Eurosystem flows



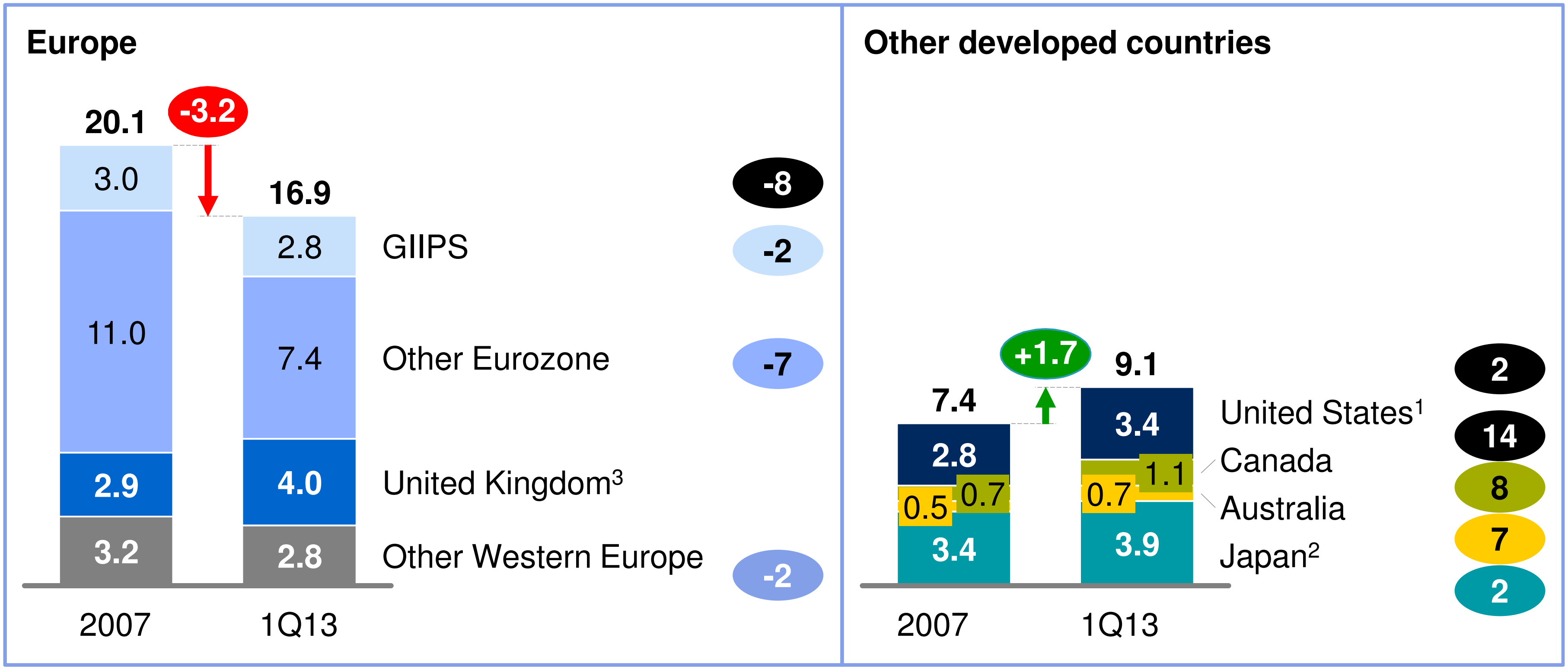
1 Includes inflows via EFSF/ESM, bond purchase programs, and the TARGET2 system.
2 GIIPS comprises Greece, Ireland, Italy, Portugal, and Spain.
3 Non-annualized total inflows up to 3Q12.

SOURCE: ECB; individual central bank balance sheets; Eurostat; press releases; McKinsey Global Institute analysis

US and other developed country banks have expanded foreign assets—but not enough to offset the decline of European banks

Compound annual growth rate, 2007–1Q13 (%)

Advanced-economy banks' cross-border claims, by nationality of bank
$ trillion, constant 2011 exchange rates

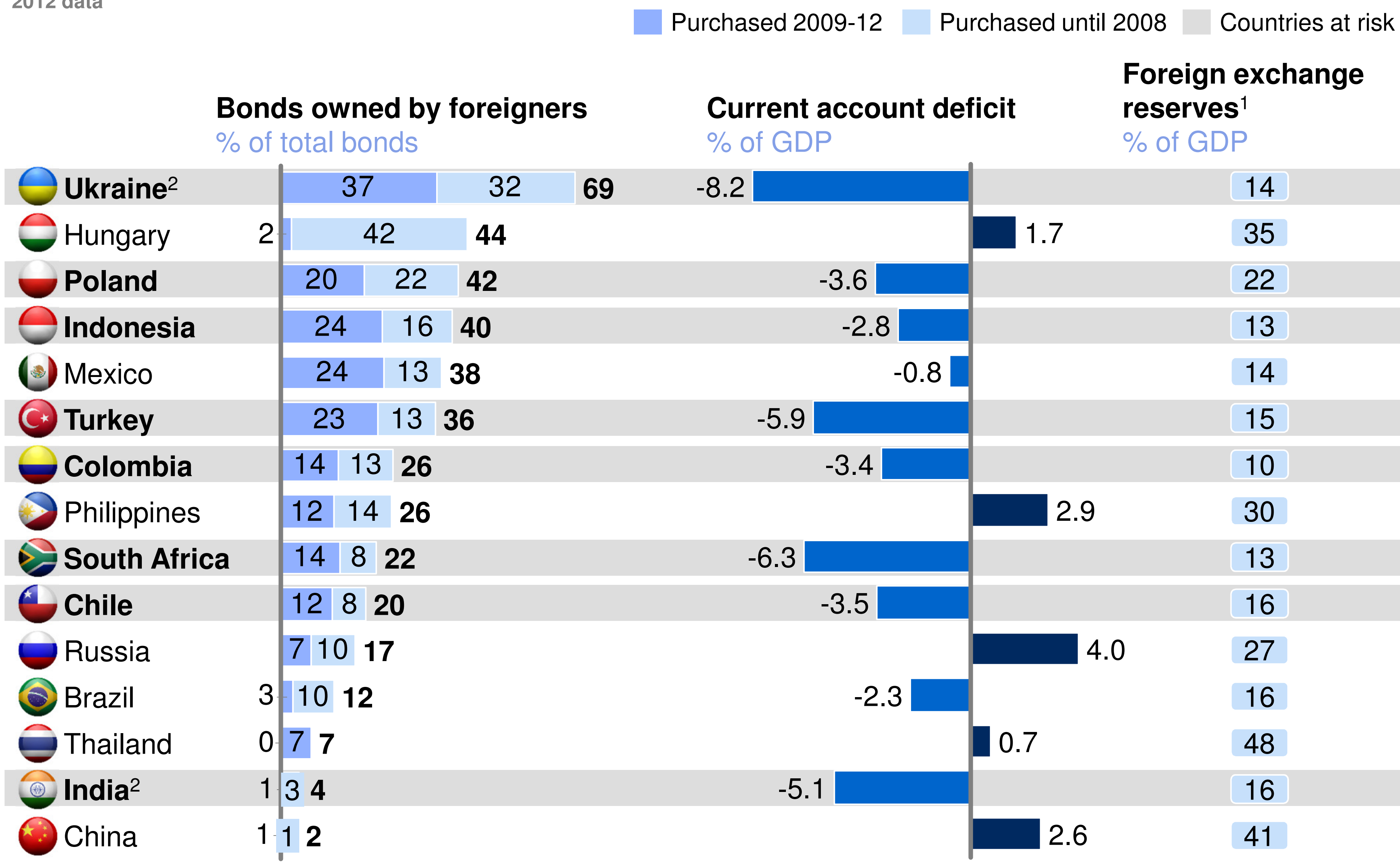


1 In 2009, US banks added a large amount of off-balance assets bank on their balance sheets. To ensure comparability between 2007 and 1Q13 figures, the data in the exhibit assumes these assets were on bank balance sheets in both periods.
2 In nominal $, Japanese bank foreign claims increased by $0.9 trillion between 2007 and 1Q13.
3 In nominal $, UK bank foreign claims increased by $0.05 trillion between 2007 and 1Q13

SOURCE: Bank for International Settlements; McKinsey Global Institute analysis

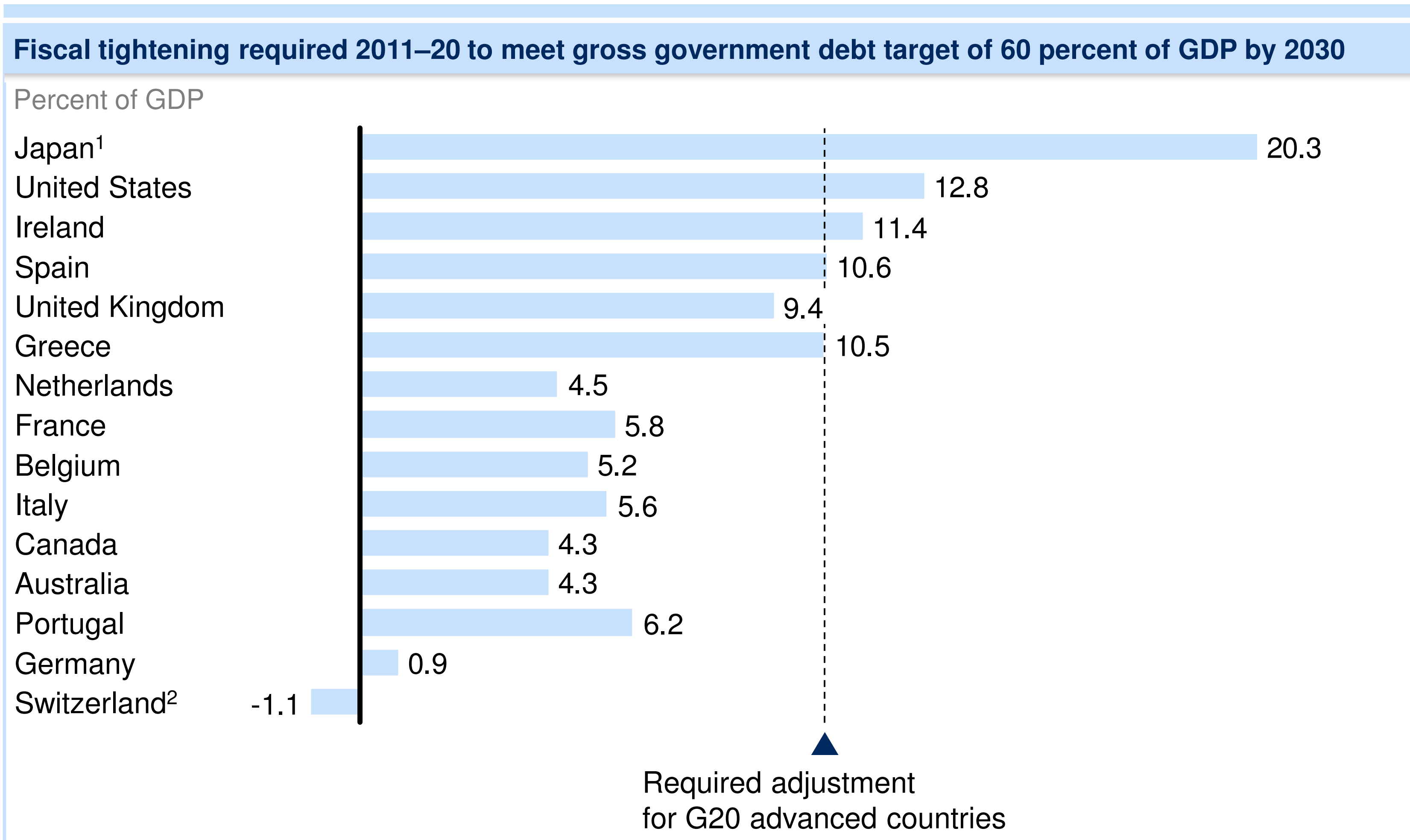
Countries to worry about are those heavily dependent on foreign investors as well as with large current account deficits

2012 data



SOURCE: McKinsey

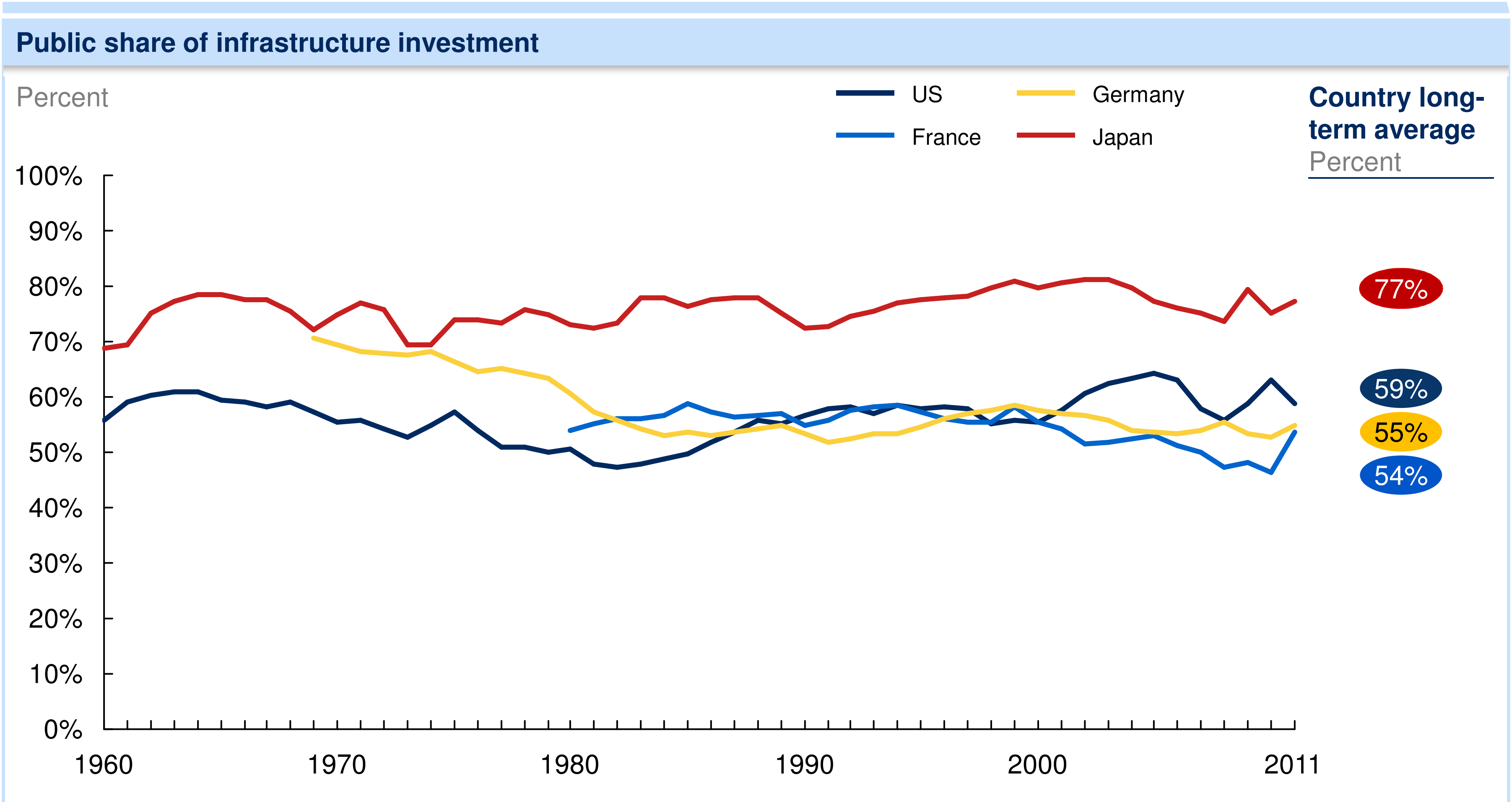
Restoring government debt to 60 percent of GDP by 2030 will require painful fiscal adjustment in many countries



NOTE: Countries are assumed to undergo a gradual transition in their primary balance over 2011–20 and maintain a constant primary balance after 2020.
1 Japan's target for fiscal adjustment is set at 80 percent of GDP.
2 Switzerland's target level is to stabilize debt at the end-2011 level by 2030.

SOURCES: International Monetary Fund Fiscal Monitor October 2012; McKinsey Global Institute.

Government austerity plans may reduce future infrastructure investment, since they currently fund over half

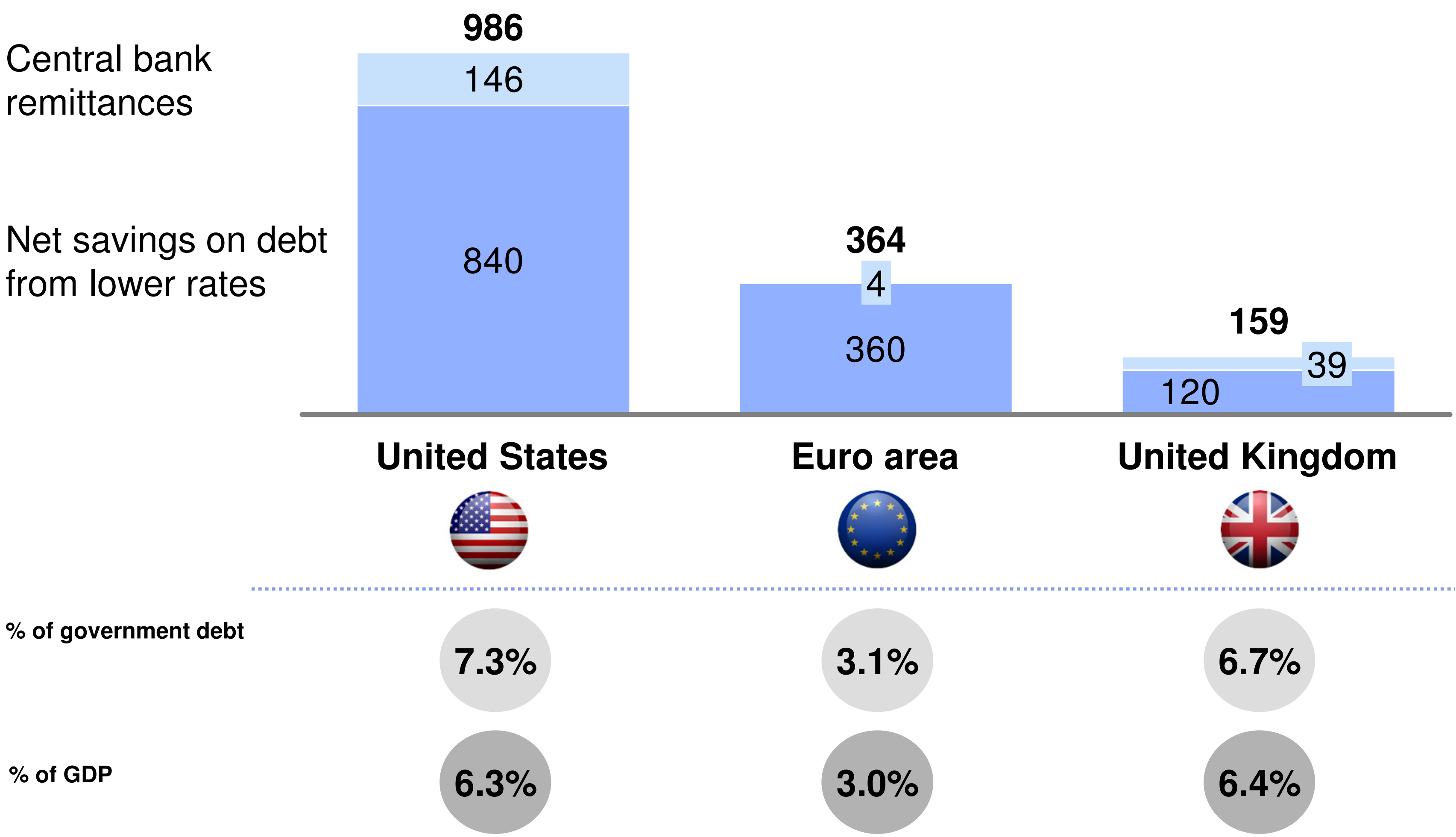


NOTE: Public investment includes investment in highways and streets, transportation, power, sewer systems, water systems, education and health care structures. Private investment includes private investment in nonresidential structures in power, communication, and other (about 30% of total, including religious, educational, vocational, lodging, railroads, farm, and amusement and recreational structures, net purchases of used structures, brokers' commissions on the sale of structures, roads and highways).

SOURCE: McKinsey Global Institute.

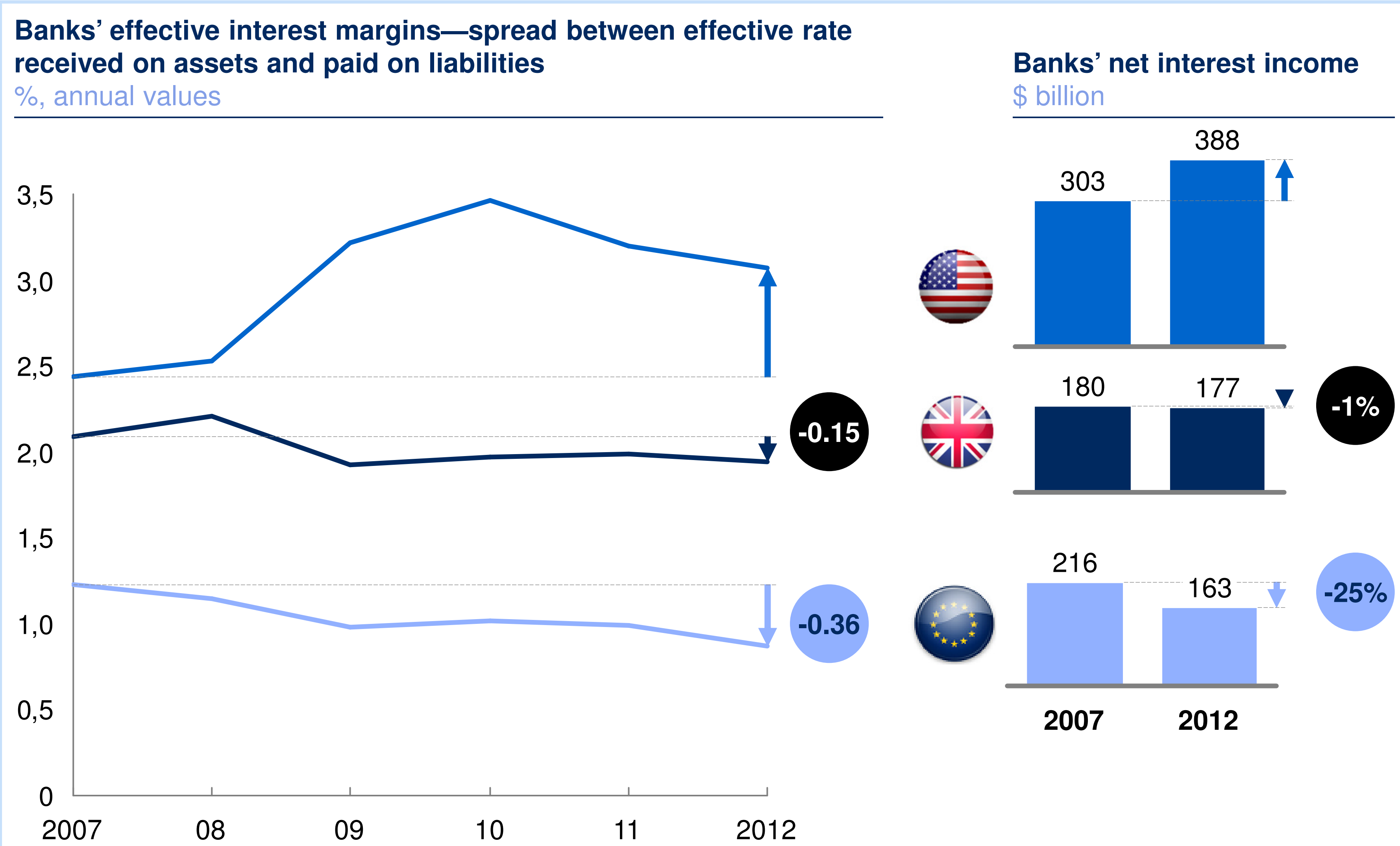
As current monetary policy ends up, Government will face increased pressures…

Estimated cumulative net savings on debt, 2007–12
Constant 2012 exchange rate $ billion



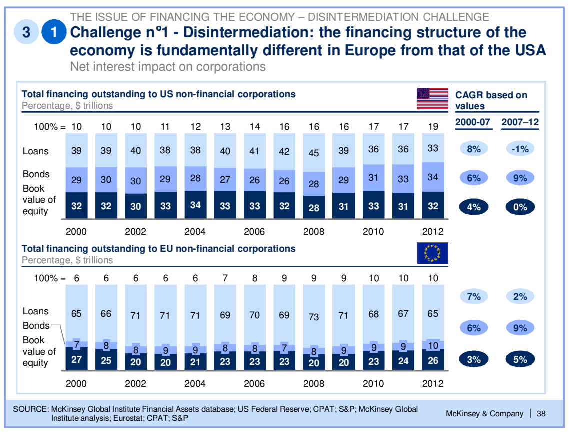
SOURCE: McKinsey

… as well as parts of the banking industry

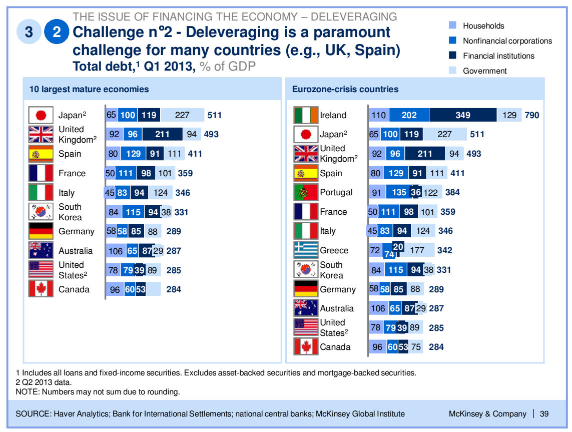


In the end, the European economy in particular faces several serious challenges

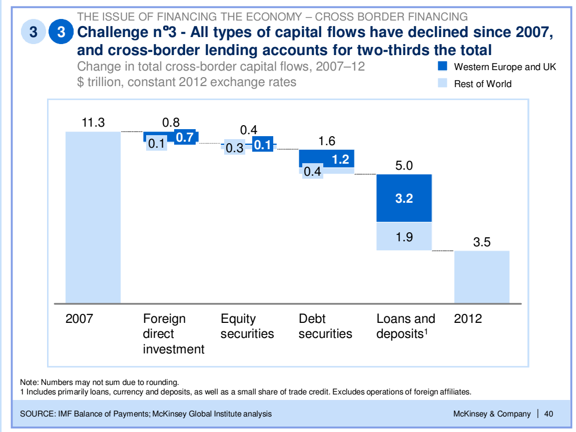
1 The challenge of financial disintermediation



2 The deleveraging challenge



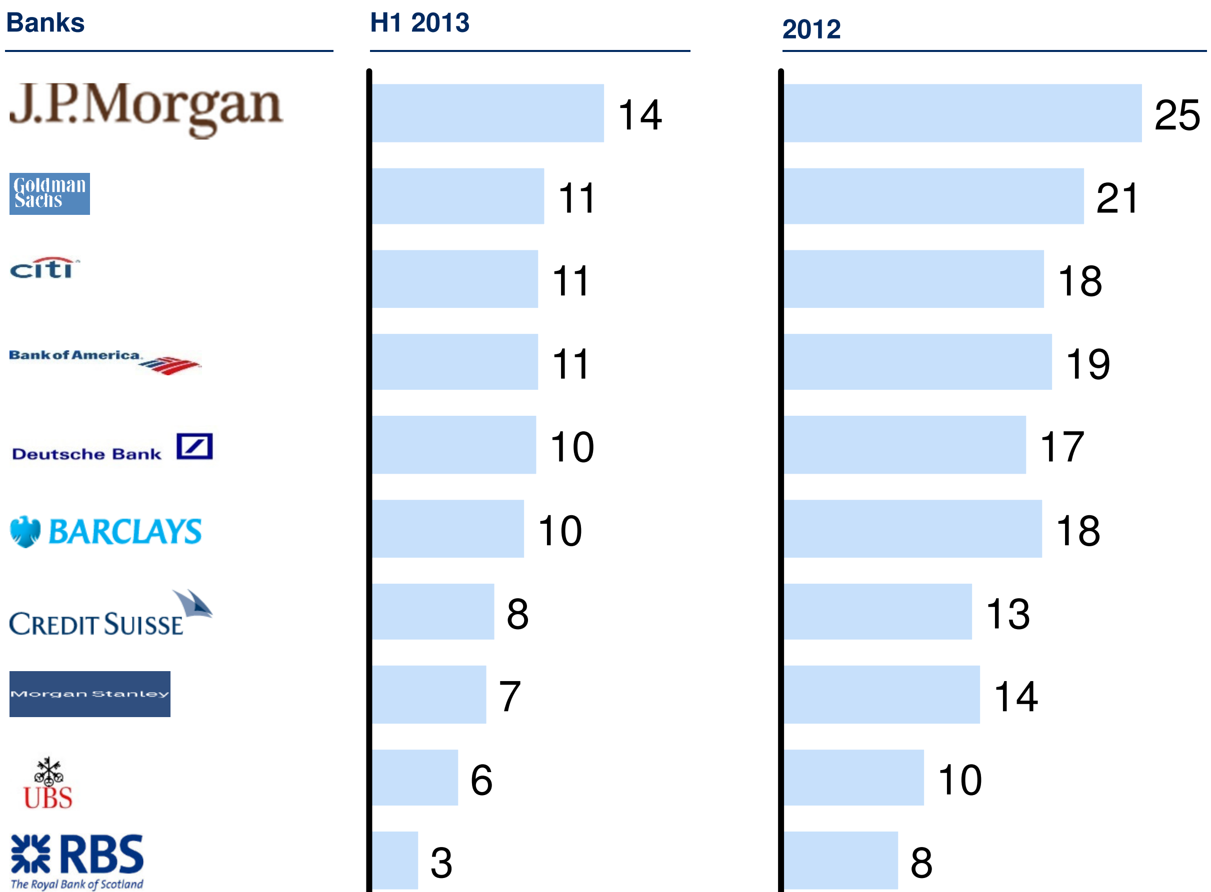
3 The challenges posed by the decline in cross-border flows



… And possibly a fourth challenge

Global CMIB[1] revenue

USD Billions



In CMIB, 6 out of the top 10 banks are American. Only one is headquartered in the Euro zone

1 Includes Investment banking / Origination &Advisory ,Fixed Income Credit and Currencies, Equities Sales & Trading and Proprietary trading

All proposals by the Group of Thirty in detail

Objectives	Proposals
Ensure investors are better able to take a long-term horizon in their investment decisions	▪ National regulators and international bodies such as the IMF, World Bank, OECD, and the Financial Stability Board should propose new best-practice guidelines to promote long-term horizons in the governance and portfolio management of public pension funds and sovereign wealth funds ▪ National policy makers should consider steps to differentiate between short-term and long-term debt (whether public or private), and weighing the pros and cons of phasing out the preferential treatment of sovereign debt in insurance and bank regulation over an extended time horizon ▪ The Financial Stability Board, in coordination with relevant standard-setting bodies, should review the regulatory and accounting treatments of assets held with long-term horizons to avoid excess focus on short-term market volatility
Create new intermediaries and instruments geared toward the provision of long-term finance	▪ Create new instruments to enable the public sector to leverage private sector capital for long-term financing ▪ Create dedicated long-term financing institutions ▪ Foster the development of long-term pension and insurance-based savings by, for instance, setting up compulsory auto-enrolled savings programs ▪ Redirect structural surpluses in national savings to diversified sovereign wealth funds with a long-term investment mandate
Develop debt and equity capital markets in order to promote a broad spectrum of financing instruments	▪ Implement the Financial Stability Board and standard-setting bodies' regulatory reforms to transform shadow banking into resilient market-based finance ▪ Promote development of corporate bond markets and securitization of long-term debt, particularly in Europe and emerging markets ▪ Develop the infrastructure for capital markets in emerging economies to lengthen financing horizons and diversify sources of funding ▪ Remove the bias against equity in countries where it is present
Ensure that cross-border flows support the efficient global allocation of capital to long-term investment	▪ Support the international diversification of investment portfolios in both developed and emerging markets ▪ Move gradually toward liberalization of capital accounts in emerging markets while maintaining financial stability, using macro prudential policy tools
Strengthen systemic analysis when setting future regulatory policy	▪ Policy makers should consider the systemic impact of ongoing and future regulatory changes on long-term investment ▪ National authorities should improve the collection of data statistics on the supply of and demand for global long-term finance

SOURCE: Group of Thirty

The EC has done their own analysis and has asked for advice via 30 consultation questions until end of June

Themes	Major concerns seen by EC
The supply of long-term financing and characteristics of long-term investment	▪ Public resources should not replace private financing ▪ Corporate savings have increased for LCs – SMEs suffer from lack of liquidity ▪ Households are more and more preferring short-term savings ▪ FDIs made a recovery in 2011 – but after a steep decline in recent years
Enhancing the long-term financing of the European economy	
The capacity of financial institutions to channel long-term finance	▪ Commercial banks are hit by the new regulation (deleveraging, etc.) ▪ National and multilateral development banks should not crowd-out private financing – they should strive to catalyze private financing in areas where it is slow to come forward ▪ Institutional investors are partly also suffering from upcoming regulations (Solvency II) or are lacking the required skills (risk and liquidity management)
The efficiency and effective-ness of financial markets to offer long-term financing investments	▪ Only LCs have an access to European bond markets ▪ Covered bond markets are fragmented along national lines ▪ Securitization needs to be mobilized again – especially with simple structures for SMEs ▪ European project bond market initiative still at small scale
Cross-cutting factors enabling long-term saving and financing	▪ Taxation often favors debt over equity investments ▪ Accounting principles sometimes hinder a long-term horizon (e.g., fair value acc.) ▪ AM incentives are often not designed to long-term horizon ▪ Quarterly reporting, benchmarks and credit ratings foster a short-term view
The ease of SMEs to access bank and non-bank financing	▪ Current measures to address the difficulties of SMEs to access finance may not be sufficient ▪ Further steps should include – developing venture capital, dedicated markets and networks for SMEs, new securitization instruments for SMEs, standards for credit-scoring assessments of SMEs, promoting other "non-traditional" sources of finance (e.g., leasing, supply-chain financing, crowd-funding, …)

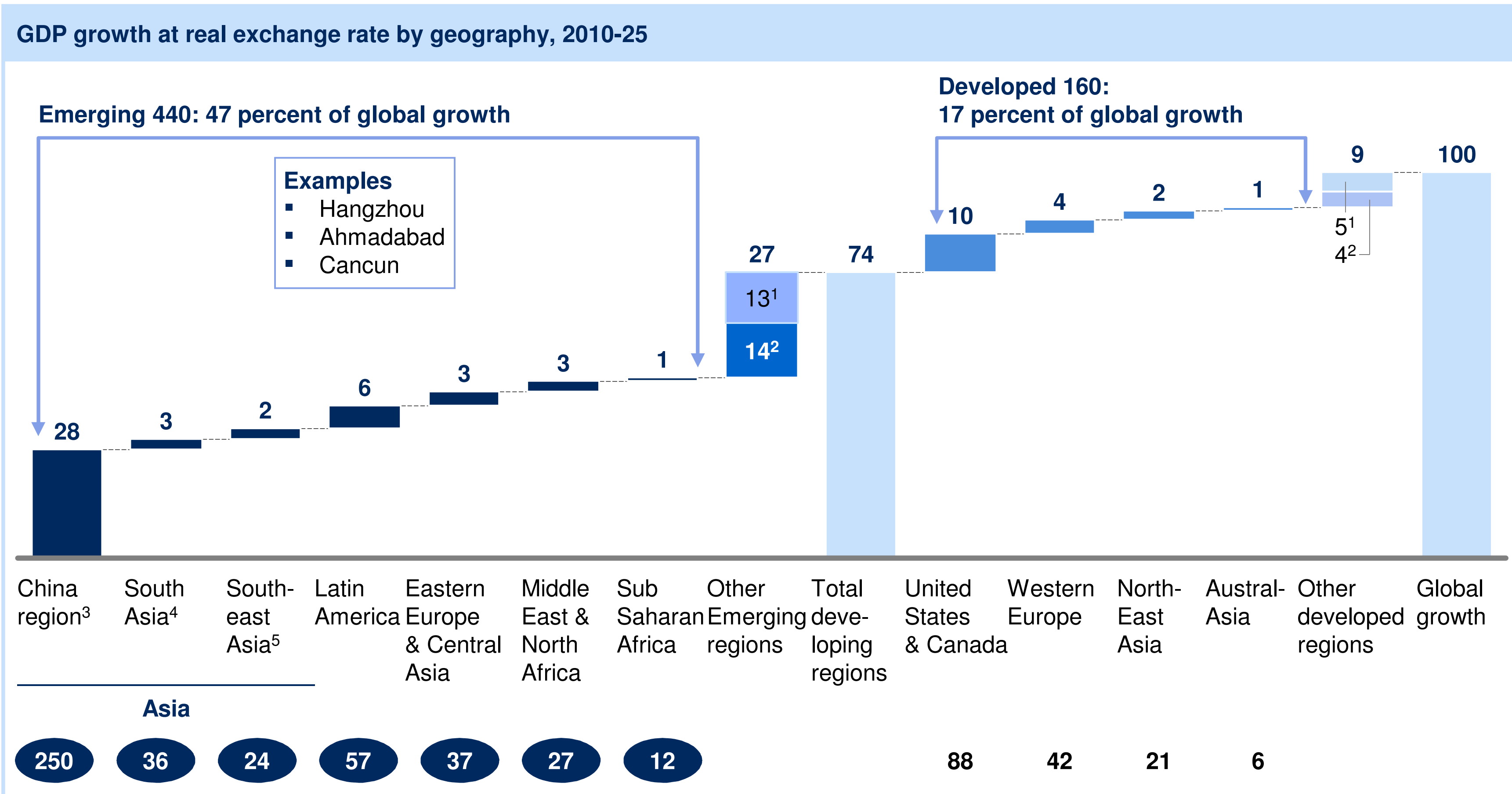
SOURCE: EC Green Paper

BACKUP

The great rebalancing: 440 emerging cities (>2 million habitants) will capture ~50% of the world growth by 2025

Number of cities in the City 600

100% = $50.2 trillion

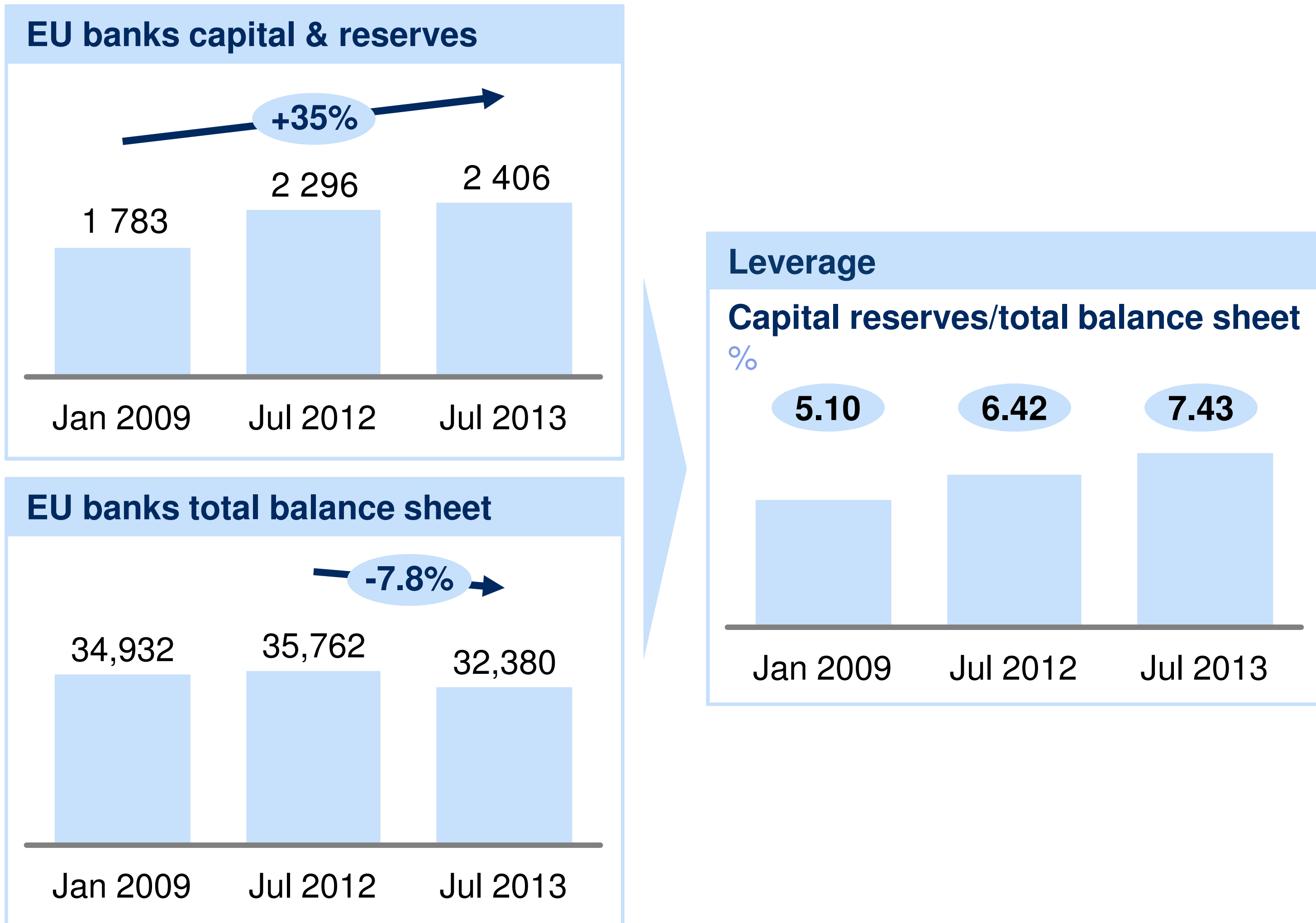


1 Small cities and rural areas. 2 Other large cities not included in the City 600. 3 Includes cities from China (Hong Kong and Macau) and Taiwan.
4 Includes cities from Afghanistan, Bangladesh, India, Pakistan, and Sri Lanka.
5 Includes cities from Cambodia, Indonesia, Laos, Malaysia, Myanmar, P.N. Guinea, Philippines, Singapore, Thailand, Vietnam.
Note: Numbers may not sum due to rounding.

SOURCE: McKinsey Global Institute Cityscope 2.0

Under the pressure of the macro-economic landscape and regulatory framework, European banks have achieved fast adjustment to new ratios

€ billions



SOURCE: ECB

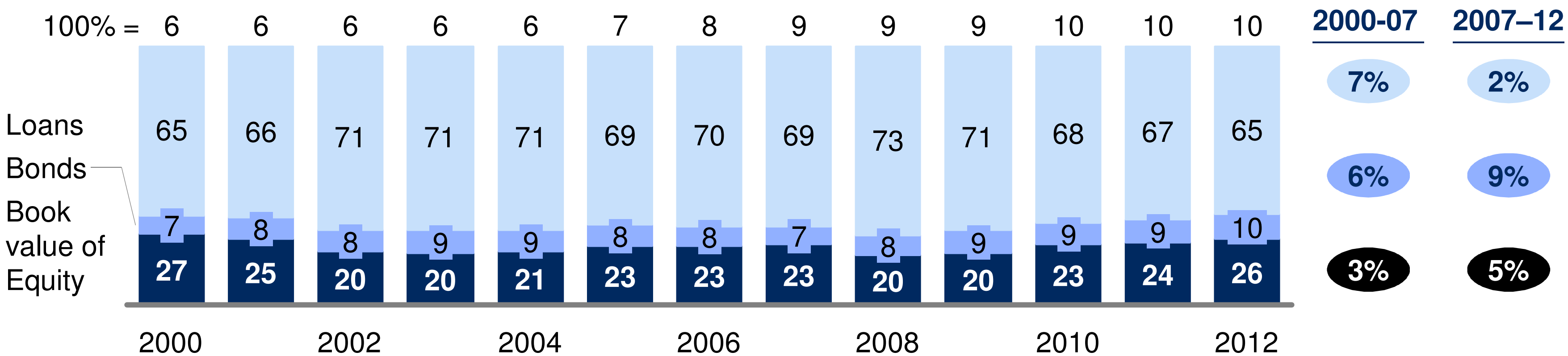
Challenge n°1 - Disintermediation: In Europe the economy remains largely financed by bank loans vs. financial markets

Net interest impact on corporations

Total financing outstanding to EU non-financial corporations

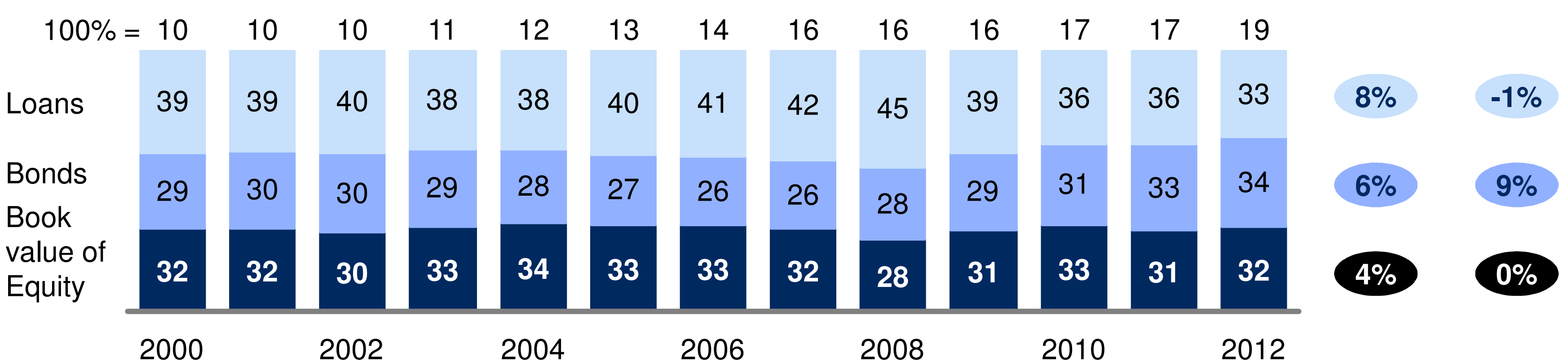
Percentage, $ trillions

CAGR based on values



Total financing outstanding to US non-financial corporations

Percentage, $ trillions



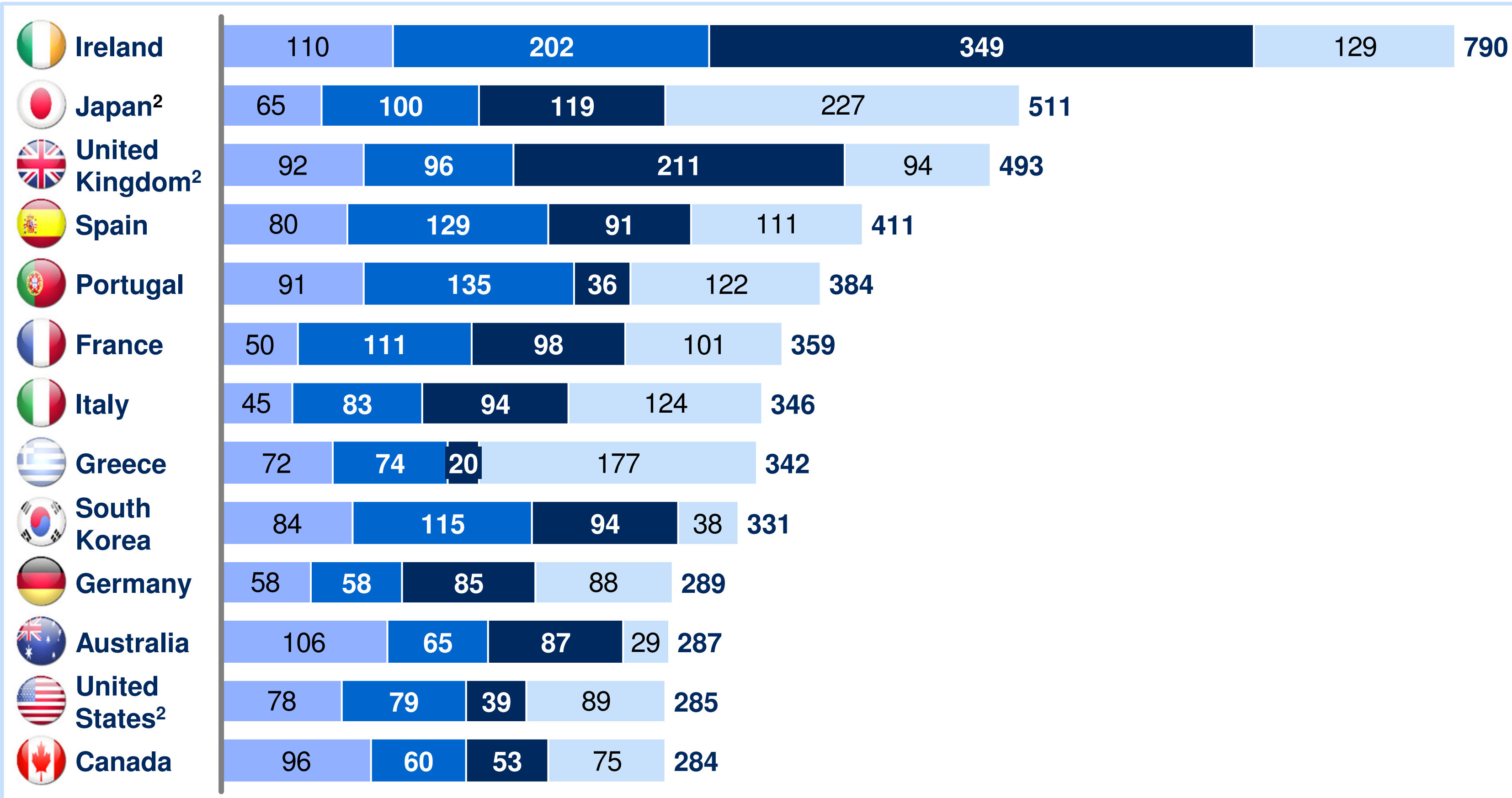
SOURCE: McKinsey Global Institute Financial Assets database; US Federal Reserve; CPAT; S&P; McKinsey Global Institute analysis; Eurostat; CPAT; S&P

Challenge n°2 - Deleveraging has become a challenge for many European countries

Total debt,[1] Q1 2013

% of GDP

Households
Nonfinancial corporations
Financial institutions
Government



NOTE: Numbers may not sum due to rounding.

1 Includes all loans and fixed-income securities. Excludes asset-backed securities and mortgage-backed securities.

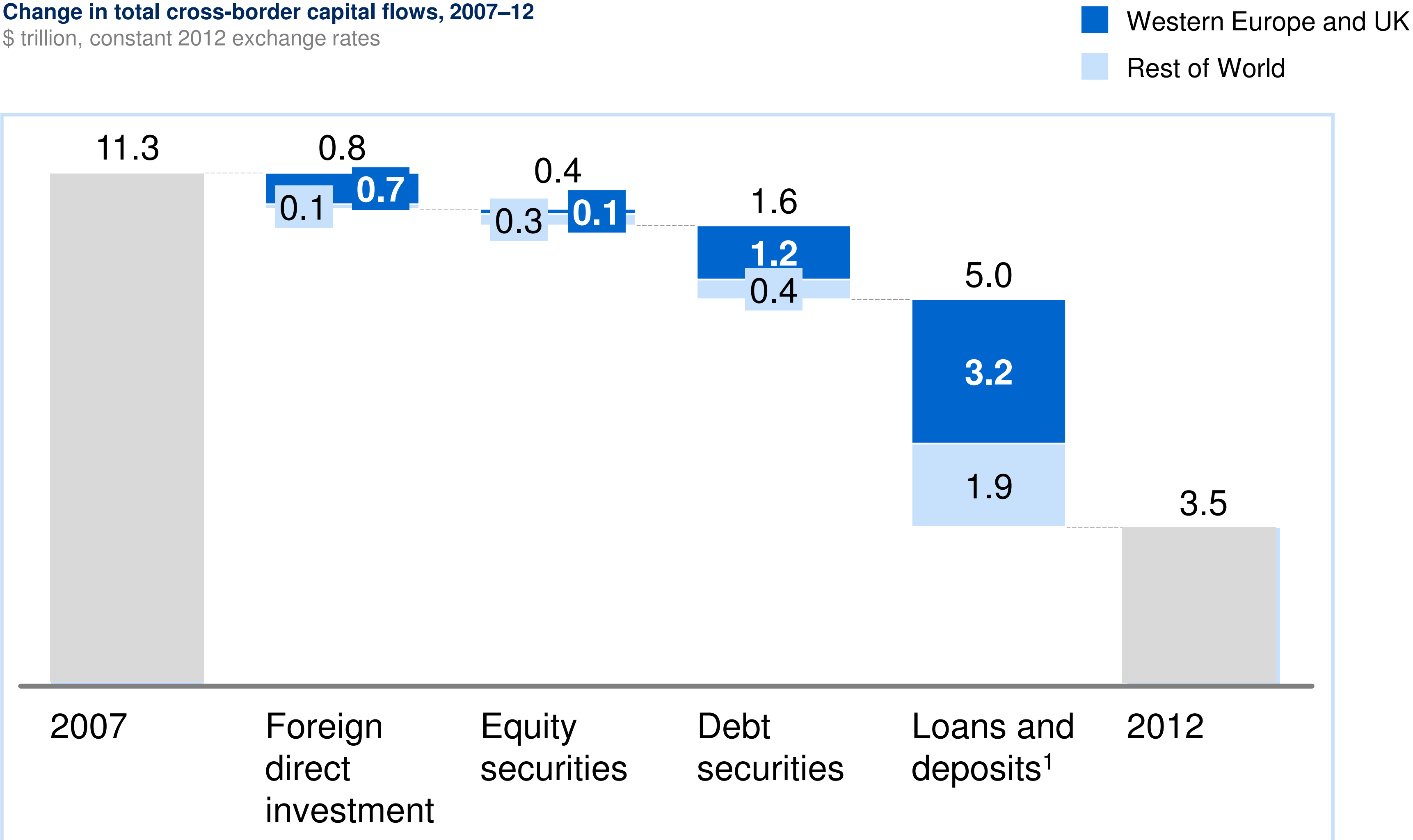
2 Q2 2013 data.

SOURCE: Haver Analytics; Bank for International Settlements; national central banks; McKinsey Global Institute

Challenge n°3 - All types of capital flows have declined since 2007, and cross-border lending accounts for two-thirds the total

Change in total cross-border capital flows, 2007–12

$ trillion, constant 2012 exchange rates



Note: Numbers may not sum due to rounding.

1 Includes primarily loans, currency and deposits, as well as a small share of trade credit. Excludes operations of foreign affiliates.

SOURCE: IMF Balance of Payments; McKinsey Global Institute analysis