The Importance of Wholesale Financial Services to the EU Economy 2008

July 2008

London Economics

The Importance of Wholesale Financial Services to the EU Economy 2008

CITY OF LONDON

July 2008

London Economics

The Importance of Wholesale Financial Services to the EU Economy 2008

London Economics

11-15 Betterton Street
London WC2H 9BP
Telephone +44 20 7866 8185
Fax +44 20 7866 8186

http://www.londecon.co.uk/

DOMINE DIRIGE NOS
CITY OF LONDON

July 2008

The Importance of Wholesale Financial Services to the EU Economy 2008 is published by the City of London. The authors of this report are London Economics.

July 2008

PO Box 270, Guildhall
London
EC2P 2EJ

http://www.cityoflondon.gov.uk/economicresearch

Table of Contents

Foreword

Stuart Fraser

Chairman, Policy and Resources Committee

City of London

This is the third edition of *The Importance of Wholesale Financial Services to the EU Economy.* The latest report, undertaken for us by London Economics, demonstrates the pivotal importance of wholesale financial services activity to the prosperity of the EU economy. It examines recent economic developments in the sector during a very difficult period for the industry following the global credit crunch. A key part of this report is an analysis of the factors that determine the medium-term outlook for the sector.

Despite the high costs of implementation of the EU MIFID directive, its coming into force in November has been one of the welcome products of the Financial Services Action Plan (FSAP) designed over time to bring greater integration and hence efficiency to the provision of European wholesale financial services. Innovations are underway in the EU that will see further substantial integration of the wholesale financial services markets. These will continue to drive down the costs of trading, and in turn allow Europe to improve the value of its global offer in wholesale markets. This is therefore a good time to review developments of the market during a testing time for market resilience.

With output of EU wholesale financial activity reaching €225bn in 2007, the industry is a true world leader, accounting for over 50% of global wholesale financial services exports, and with a large and growing share of global wholesale financial output. The industry employs nearly 1.4m people and has accounted for nearly two-thirds of the increase in EU economic-wide labour productivity since 2000.

The comparative success of the wholesale financial services industry in the EU reflects the substantial benefits of open markets and the way in which integration delivers benefits by exploiting economies of scale, scope and agglomeration for Europe's key financial centres. This is seen in the increasing levels of cross-border mergers and acquisitions in the financial sector, and the growing share of assets of branches and subsidiaries of credit institutions in the EU held by non-domestic credit institutions from the EU. That this comes from the cluster effect is illustrated by the fact that just five of the EU Member States account for 70% of EU27 wholesale financial activity in 2007, with the UK alone accounting for over a third of the total.

The report also shows how important the key factors are that drive future growth of the industry: the state of the domestic and world economies; the level of savings; competition from emerging financial centres; tighter regulation; and the innovative business models pursued by the players in the market.

This is a challenging period for the industry with the introduction of the new open market initiatives in Europe following the FSAP. The current uncertainties surrounding global demand for financial services in a context of slowing world growth mean that the EU wholesale financial services sector faces a number of downside risks. We need to ensure that during this period policy-makers continue to encourage integration, open markets and well-judged innovation in the sector, allied with proportionate regulation. There is every reason to believe that following on from the current turmoil, the industry will move to substantially higher levels of activity in the medium to long-term.

Stuart Fraser

London

July 2008

Executive Summary

The Importance of Wholesale Financial Services to the European Union Economy 2008 is the third annual report on this topic published by the City of London.

The EU27 is the world's leading exporter of wholesale finance services accounting for over 50% of the global total. The EU27 wholesale financial sector is the second largest in the world after the US sector accounting for nearly one-third of global output in 2007.

The output of the EU27 wholesale financial sector reached €225 billion in 2007. It grew more than twice as fast as economy-wide output between 2002 and 2007. In 2007, five Member States (United Kingdom, Germany, France, the Netherlands and Belgium) accounted for 70% of total EU27 output of wholesale financial services. These five along with a further five Member States (Ireland, Spain, Denmark, Italy and Luxembourg) accounted for 92% of the EU27 total.

Employment in the EU27 wholesale financial industry is estimated at 1.36 million in 2007. The wholesale finance sector accounted for 5.5 percentage points of the 9.5% cumulative increase in EU27 economy-wide cumulative labour productivity between 2000 and 2007.

The wholesale financial services industry had to deal with a credit crisis of unprecedented character in 2007. While the impact of the crisis on the non-financial economy was very limited in 2007, it is expected to be much more pronounced in 2008 and 2009.

The **various segments of the wholesale financial services sector continued to grow robustly in 2007** although, due to the credit crunch, in a number of cases the **second half of 2007 turned out to be very subdued**.

The EU leads the world in a number of wholesale finance markets. The EU holds a world-leading 58% of international debt securities by value. It accounts for nearly half of foreign exchange turnover, and it also enjoys a leading turnover share in both interest rate and currency derivatives.

A number of key drivers will have a substantial impact on future growth of the EU27 wholesale financial services industry. These are: a) the overall health of the domestic and world economies; b)the level of savings that will need to be intermediated; c)increased competitive pressures from established and emerging financial centres outside the EU27; d) changes in regulatory framework; and, e)changes in business models pursued by the various players in the market place.

In the near term, reflecting the employment cut-backs announced so far, **the EU27 wholesale financial sector is projected to decrease in size through 2008 and 2009.**

The medium-term outlook for the sector will be largely determined by the key drivers. The effects of these key drivers are explored in four alternative scenarios giving four different medium-term outlooks for the industry.

Scenario 1: the benign world scenario. In this first scenario, the medium term recovery of the EU27 economy proceeds at the pace predicted by the IMF over the medium term. The EU27 wholesale financial services sector remains internationally competitive, and the regulatory response to the credit crisis is limited in scope.

Scenario 2: the challenging world scenario. In this scenario, the EU27 wholesale financial services industry faces a number of serious challenges over the coming years. While the economy expands at the same pace as in the previous scenario, the EU27 wholesale financial services sector faces domestically a much more stringent regulatory response and internationally a loss of competitiveness.

Scenario 3: the stressful world scenario. This scenario compounds the sector's woes (assumed in scenario 2) by assuming a weaker economic outlook. Inflationary pressures currently present in many economies and the likely responses of central banks to such inflationary pressures suggest that a worse-than-currently expected economic growth outlook cannot be totally ruled out.

Scenario 4: the positive surprises scenario. This fourth scenario assumes a number of positive developments such as stronger economic growth and a higher savings rate than in the previous scenarios. Moreover, the EU27 wholesale financial services industry does not suffer any loss in international competitiveness and the regulatory response to the credit crisis is not very stringent in terms of the actual economic impact on the sector's activity level.

The first key finding to note is that under all scenarios, the level of EU27 wholesale financial services GVA in 2009 falls below the level reached in 2007. The magnitude of the decline in 2009 relative to 2007 ranges from 2.6% in the most optimistic scenario 4 to 11.2% in the most pessimistic scenario 3.

The second key finding is that the outlook for the EU27 financial services sector is much more varied over the medium term. In scenario 2, the sector's GVA in 2012 is still 0.7% below its 2007 level. In the most pessimistic scenario, the sector's GVA level in 2012 is 13.7% lower than in 2007 while in the more optimistic scenarios, the "benign world" scenario (scenario 1) and the "positive surprises" scenario (scenario 4), the sector's GVA level is respectively 8.2% and 12.9% higher (at 2007 prices) in 2012 than in 2007. The high level of variation demonstrates the importance of the key drivers in these scenarios.

In all scenarios, the impact is greatest in UK wholesale financial services. Depending on the scenarios, the predicted level of activity in UK wholesale financial services in 2012 ranges from 19.0% lower than in 2007 to 17.8% higher.

In the case of France, Germany, Italy and Spain, four Member States with relatively large wholesale and investment banking sub-sectors, (the sub-sector which is most affected in all scenarios), the prediction ranges, on average, from an activity level which is 14.3% lower to 13.4% higher in 2012 than in 2007. In contrast, in the case of the other Member States, the prediction ranges, on average, from -3.7% to +3.5%.

1 Introduction

The present report, the third in a series of annual reports, focuses on recent developments in the wholesale financial services sector in the EU and the contribution this sector makes to the EU economy.

It should be noted that the official industry statistics published by international and national statistical agencies, do not distinguish wholesale financial services from other financial intermediation activities such as retail banking.

In the present report, as in the two previous editions, we therefore define wholesale finance as "*financial services which are conducted between financial services companies and institutions such as banks, insurers, fund managers, and stockbrokers*"[1]

In terms of financial sub-sectors, this report examines recent developments in:

- banking, especially investment banking;
- equity markets;
- debt markets;
- foreign exchange markets;
- derivative markets;
- asset management;
- insurance;
- private equity;
- hedge funds; and,
- commodities markets.

The report is structured as follows:

- Chapter 2 briefly reviews key developments in the wholesale financial services sector in 2007 and early 2008;
- Chapter 3 discusses the evolution of wholesale financial services in 2007 relative to previous years, and examines the integration of wholesale financial services in the global economy;

[1] City of London, *The Importance of Wholesale Financial Services to the EU Economy 2007*, p. 10.

- Chapter 4 provides information on the size of the wholesale financial services sector in each EU Member State in terms of output and employment, and reviews the contribution of the sector to economy-wide growth in output, employment and productivity.

- Chapter 5 reviews the various financial sub-sectors listed here and assesses the contribution of these sectors in aggregate to the EU economy;

- Finally, Chapter 6 analyses the factors which are likely to shape the wholesale financial sector in the EU over the coming years and presents four scenarios for the sector over the next five years.

2 2007 and Early 2008 - a Turbulent Period

2.1 The financial sector

This chapter provides a brief overview of a number of salient developments in 2007 and sets the stage for the more detailed discussion of developments in wholesale finance in 2007. Readers interested in a more in-depth analysis of the events in the financial sector in 2007 are invited to consult, among others, recent reports and studies by the International Monetary Fund (IMF), the Bank for International Settlements (BIS), the Bank of England and the European Central Bank.[2]

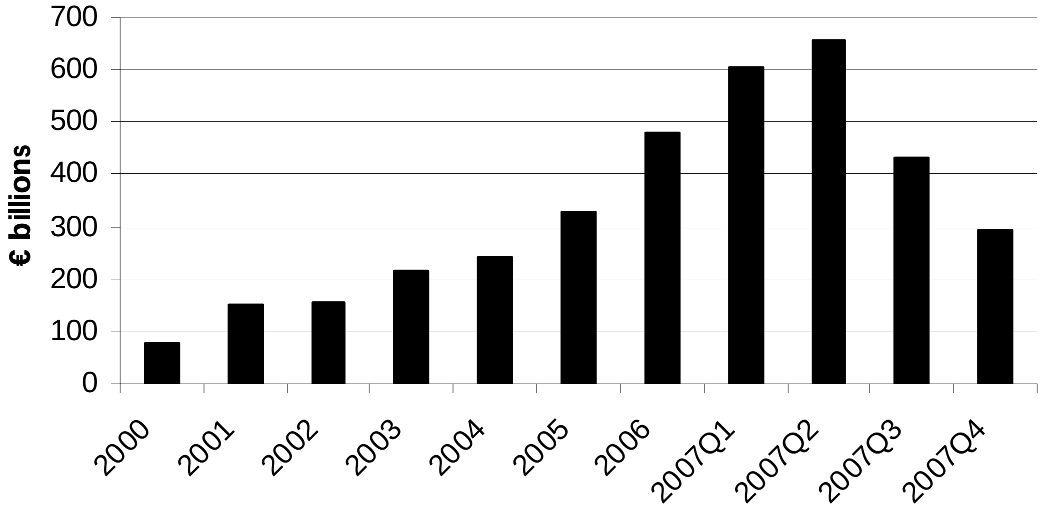
The year 2007 will stand out as watershed for the financial sector. After a number of years of operating in a relatively benign environment, the exceptionally high level of activity and the extensive growth in financial engineering of previous years were severely tested by the US sub-prime crisis and its fall-outs. Whilst signs of an incipient crisis emerged in late 2006, the financial sector bore the full brunt of the unfolding sub-prime crisis in the second half of 2007 and into 2008.

Securitisation of mortgage loans, including U.S. sub-prime mortgage loans and other types of loans, had grown very rapidly in recent years as this allowed a much broader investor base to invest in such instruments, was viewed as a way to diversify risks for the financial institutions which had originated the securitised loans, and allowed such institutions to expand their lending activities.

In Europe, for example, the value of securitisation issues rose rapidly from about €250 billion in 2004 to €650 billion (at an annual rate) in the second quarter of 2007. In the second half of 2007, however, new issuance value fell back by more than 50% to just below €300 billion (see Figure 1).

[2] See, for example, the April 2008 *Global Financial Stability Report* produced by the IMF, the March 2008 BIS *Quarterly Review*, the Bank of England *Financial Stability Report* of October 2007 and the *Monthly Bulletins* of the European Central Bank.

Figure 1: European securitisation issuance

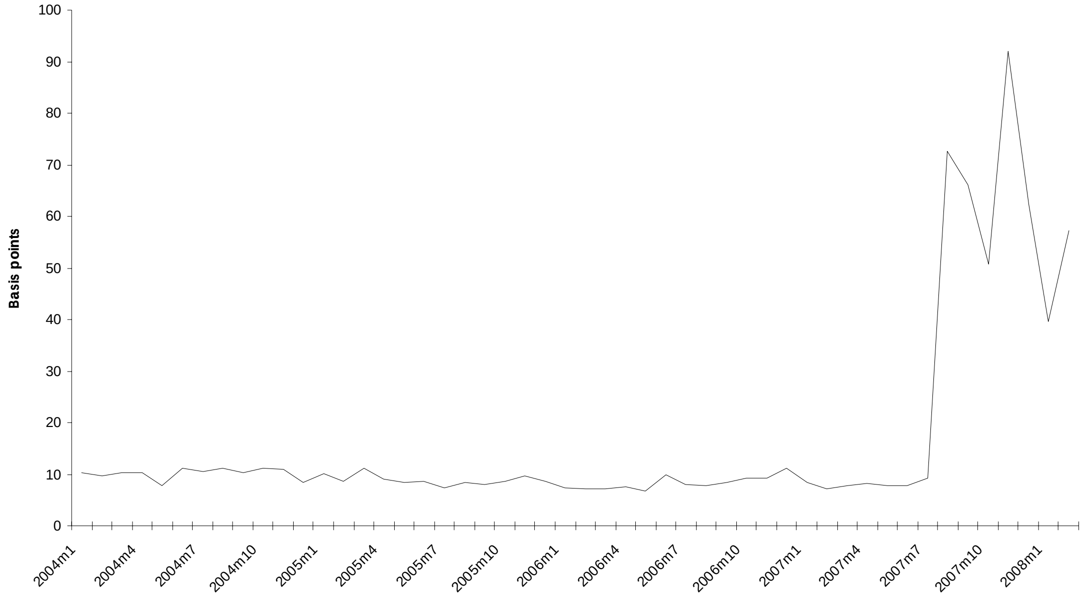


Note: quarterly data are annualised to facilitate comparison with previous years
Source: European Securitisation Forum, Securitisation Data Report, Winter 2008

Losses associated with the securitisation of sub-prime mortgages started to mount and spread to a wide range of institutions, including a number in the EU. The resulting lack of knowledge of where risk was located and new concerns about the creditworthiness of financial sector counterparts led to sharp decreases in appetite by financial institutions for lending to other financial institutions.

As a result, inter-bank lending rates rose sharply in the second half of 2007. For example, the spread between the 3-month LIBOR rate and the rate on overnight swaps rose to between 40 and 80 basis points in the second half of 2007 and the first months of 2008. This was up sharply from the typical 10 basis points spread previously observed (see Figure 2). Moreover, a substantial portion of the new issues in the second half of 2007 were retained by the issuers for internal or repo purposes and not made available to the wider investor community.

Figure 2: 3-month Libor spread to Overnight Index Swaps



Note: The basis points differential is equal to the absolute difference in yield *100
Source: London Economics calculations based on data from Bloomberg Professional

Attempts were made to counter the drying-up of liquidity and prevent serious spill-overs of the financial crisis to the non-financial economy. Through the autumn of 2007 and in the first months of 2008, central banks in the EU, UK, US, Canada and other countries repeatedly injected very large amounts of liquidity, at least by historical standards, into the banking sector.

Despite these liquidity injections, financial institutions which were dependent on wholesale financial markets found it very difficult, if not impossible, to refinance their activities. The Northern Rock episode epitomises this development, but other institutions depending on wholesale funding, although not necessarily affected as severely as Northern Rock by the funding drying up, had nevertheless to rein in their activities very substantially.

Moreover, as the price of many sub-prime mortgage related assets and other high yield assets fell sharply through the second half of 2007, many institutions had to undertake large write-downs of their portfolios and bring back onto their balance sheet high yield assets which had been put in special investment vehicles (SIV) which were funded by short-term debt.

Total sub-prime related write-downs by US and European financial institutions have been estimated so far at US$ 181 billion[3] or about €65 billion, and are

[3] Source: Waters weekly update 06 May 2008

likely to grow through 2008, especially if the deterioration of credit quality spreads to other instruments such as credit cards, consumer loans and high yield loans[4]. To shore up their capital base, a number of financial institutions turned to sovereign wealth funds (SWF) for new equity injections.

Although many of the SWFs have been in existence for years, their very significant and publicised capital injections into a number of the major world banks and other financial institutions, combined with certain high profile actual or attempted acquisitions of companies in the non-financial sector, have drawn public attention to such funds and attracted considerable policy interest.

According to the IMF tentative estimates, as of 2007, foreign assets held by sovereigns include US$5.6 trillion of international reserves and between US$1.9 trillion and US$2.9 trillion in types of SWF arrangements. Funding for practically all the SWFs comes from commodities, mainly oil, and the still on-going commodity boom is fuelling their growth.

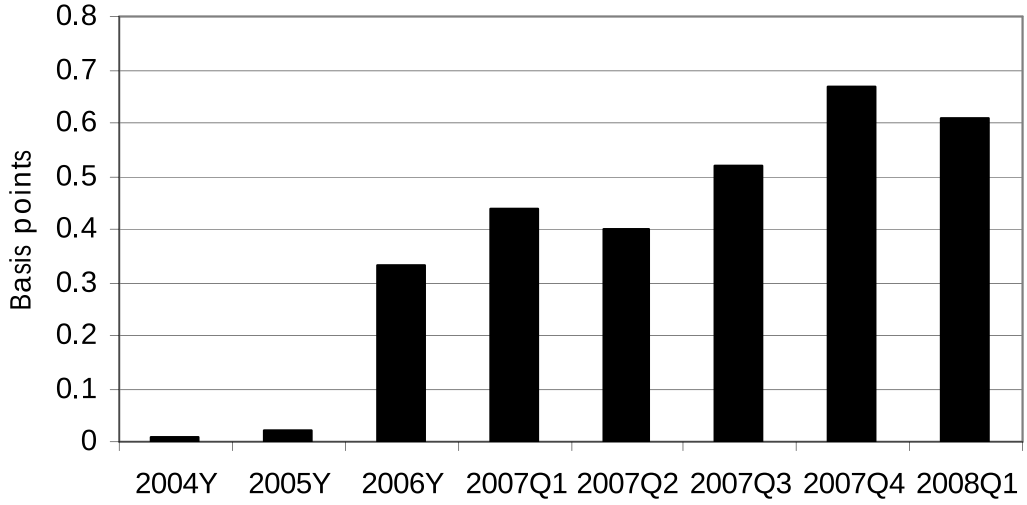
Whilst interest rates on high risk assets rose sharply as a result of a general re-assessment and re-pricing of the credit risk in the second half of 2007, even instruments that were less risky experienced significant yield re-pricing.

As an example, Figure 3 shows that the spread between the yield on corporate Eurobonds of more than 5- years and the yield on 10-year German government bonds widened from practically nil in 2004 and 2005 to more than 60 basis points in the fourth quarter of 2007 and the first quarter of 2008.

---

[4] According to the latest estimates from the IMF, bank losses world-wide could be as high as US$945 billion or €610 billion. See IMF, *Global Financial Stability Report*, April 2008.

Figure 3: Spread (in basis points) between yield on corporate Eurobonds of more than 5 years and German Government bonds of 9 to 10 years

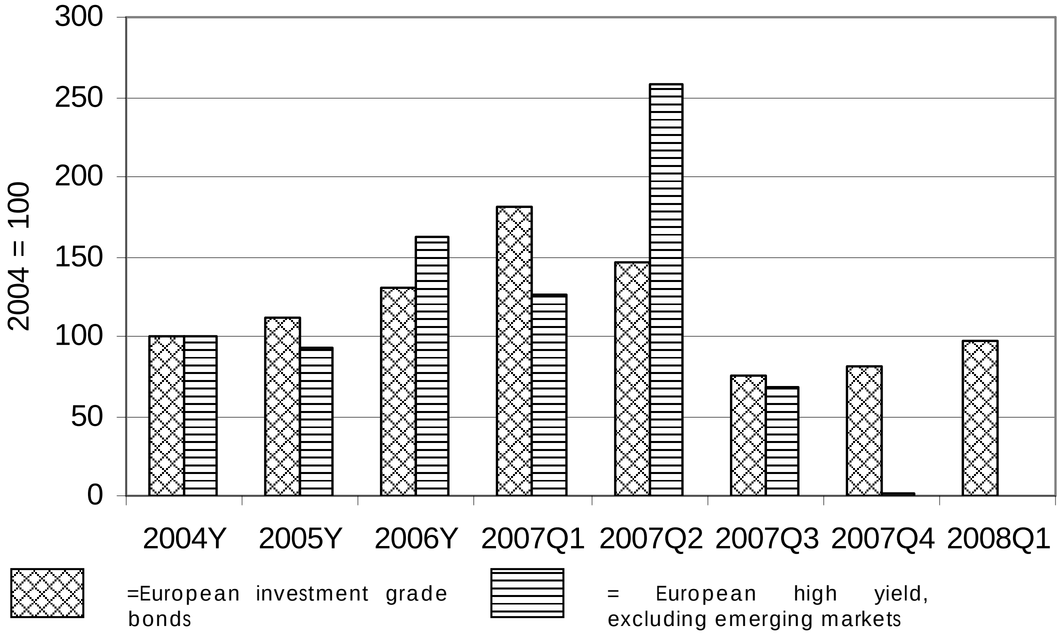


Note: The basis points differential is equal to the absolute difference in yield *100

Source: London Economics calculations based on data from Bloomberg Professional

In addition the volume of lending activity fell sharply. For example, the value of issues of European investment grade bonds fell by almost 55% from the 1st quarter of 2007 to the 4th quarter of that year and increased only marginally in the first quarter of 2008. New issuance of European high yield bonds (excluding emerging markets bonds) was reduced to practically nil in the 4th quarter of 2007 following a very high issue value through the first half of 2007 (see Figure 4).

Figure 4: Value of new bond issues, 2004 =100



Source: London Economics calculations based on data from Bloomberg Professional

In addition to having to deal with the fall-outs of the sub-prime crisis and its spill-over impacts on other highly leveraged financial instruments, the financial and non-financial sectors also had to adjust to the continuing depreciation of the US dollar against the major currencies through 2007, a trend which had started by mid-2006.

For example, the UK pound appreciated by almost 9.5% against the US dollar from July 2006 to December 2007, while the euro appreciated by almost 15% over the same period (see Figure 5). The depreciation of the US dollar against the euro, the yen, and on a trade-weighted basis, continued well into 2008. In contrast, the US currency regained some ground against the UK pound in the first quarter of 2008.

Figure 5: Exchange rates of major currencies vis-à-vis US$, 2004 =100

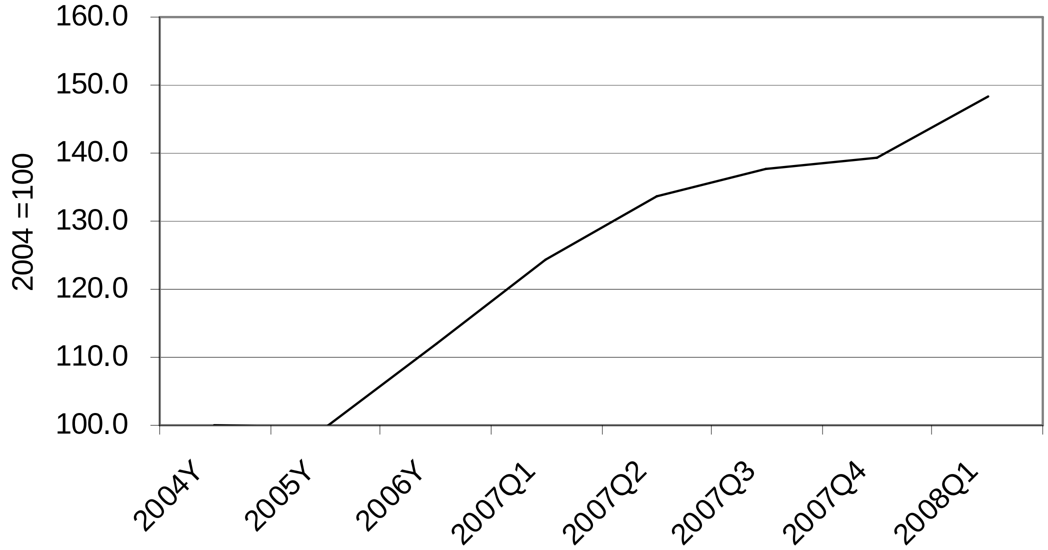
Note: An upward movement represents an appreciation of the currency vis-à-vis the US$ and a downward movement a depreciation. The trade-weighted exchange rate is the broad trade-weighted exchange rate published by the Federal Reserve Board

Source: London Economics calculations based on data from Bloomberg Professional

The pace of commodity price increases, which had moderated in the first half of 2007, accelerated again through the second half of 2007 and into 2008. Overall, according the Reuters-CRB index, commodity prices (in US$) increased by about 20% from the first quarter of 2007 to the first quarter of 2008.

Obviously, such substantial commodity price increases, if sustained for a prolonged period, will put upward pressures on producer and consumer prices and may limit the central banks' room for manoeuvre in addressing the expected weakening of the non-financial sector. Despite this, very buoyant commodity markets have attracted the investment interest of some financial sub-sectors and stimulated trading in commodity derivatives, as shown in Figure 6.

Figure 6: Commodity price index in US$, 2004 =100



Note: Commodity price index = Reuters - CRB index (CCI), indexed to 2004 Q1=100
Source: London Economics calculations based on data from Bloomberg Professional

2.2 The economy as a whole

At the end of 2007, the non-financial sectors of the economy - with the exception of the construction sector in a number of countries - had not yet been significantly affected by the unfolding sub-prime crisis.

The IMF's April 2008 *World Economic Outlook* estimated that world GDP grew by 4.9% in 2007, for example, only marginally less rapidly than in 2006. The deceleration in 2007 GDP growth in the US is expected to be somewhat more pronounced. Overall, however, the economic impact of the financial crisis is expected to be limited in 2007 (see Table 1).

The non-financial sector in the advanced economies is expected to be more significantly affected by the financial crisis in 2008, however, with annual world output growth expected to fall to 3.7%. Annual US GDP growth is expected to decelerate even more sharply to 0.5%.

Moreover, if the current unsettled state of affairs in financial markets were to persist well into 2008, GDP growth in 2008 is likely to be even weaker than currently expected.

Table 1: Latest GDP growth forecast by IMF				
Region/Country	**2006**	**2007 (estimate)**	**2008 (projection)**	**Difference from October projection**
World	5.0	4.9	3.7	-1.1
US	2.9	2.2	0.5	-1.4
Euro area	2.8	2.6	1.4	-0.7
United Kingdom	2.9	3.1	1.6	-0.7
Japan	2.4	2.1	1.4	-0.3
Other advanced economies	4.5	4.6	3.3	-0.5
Emerging market and developing economies	7.8	7.9	6.7	-0.7

Source: IMF, World Economic Outlook, April 2008

2.3 Conclusion: A most severe shock and an uncertain outlook

In 2007, the financial sector had to deal with a credit crisis of unprecedented nature in recent history. While central bank operations in a number of key countries have helped ease the liquidity, tensions in the inter-bank markets, and factors such as "difficulties in valuing complex financial products engineered before the crisis, a general credit deterioration, counterpart mistrust and balance sheet pressures"[5] keep the longer term premiums up.

So far, the focus in the financial sector has been on dealing with the most immediate fall-outs from the sub-prime mortgage crisis. Some of the factors that in the second half of 2007 drove up the longer-term yields on all but the most secure instruments are likely to persist well into 2008, however; these will certainly impact on the level of activity in a number of financial sub-sectors of interest in the months ahead.

[5] IMF, *Global Financial Stability Report, Market Update*, January 2008

3 The World Wholesale Finance Sector in a Globalised World

This chapter provides updated estimates of the wholesale finance activity for the world as a whole and for a number of key producers of such wholesale financial services in the EU.

It then focuses in greater detail on the globalisation of wholesale financial services by examining the latest available World Trade Organisation (WTO) data on international trade flows in wholesale finance.

3.1 The wholesale finance sector in 2007

The estimates of the size of the wholesale finance sector in the EU-27, US, Japan, China, the rest of Asia and the Pacific, the rest of Europe and the rest of the world, which are reported in Table 2, are based on a slightly modified methodology compared to the one which had been used in the previous two reports.

Methodology

In order to estimate the gross value added (GVA) of the wholesale financial services sector, the benchmark approach used in the previous reports was refined as follows:

- First, data was obtained on the contribution of financial intermediation to GDP in all 27 EU countries, the US, Japan and China. Key sources of information were Eurostat and national statistical agencies.
- Second, the share of retail finance relative to all finance in each country was estimated using a benchmarking system against twenty European countries that are not highly dependent on the financial sector. As with previous versions of the report, this benchmarking system is based on the share of financial intermediation (i.e. retail and wholesale financial services) in total domestic gross value added. In addition, this year a complementary indicator is used, namely the level of financial intermediation on a per capita basis.

  The use of the second indicator takes account of the fact that: a) the level of retail banking in an economy depends not only on the economy's GDP level but also on the size of its population; and b) population size and GDP level are not perfectly correlated.

  For each indicator, the set of 20 EU Member States was identified with: a) the lowest ratio of financial intermediation GVA to total GVA; and b) the lowest level of financial intermediation on a per-capita basis. A benchmark retail finance share was computed as the mean of the average of the two indicators across these 20 EU Member States.

- Third, the share of retail finance was deducted from all financial intermediation to arrive at an estimate of the contribution of wholesale finance to GDP in each country. In the cases where the technical application of this methodology resulted in a wholesale financial sector share of zero, this latter estimate was adjusted to allow for a very small level of wholesale financial sector activity;

- Finally, the size of wholesale finance in all other countries was estimated using financial variables in these countries, such as finance exports and the size of the stock market in the EU, US, Japan, and China.

Relative to the GVA estimates of wholesale financial sector reported in previous reports, this methodological adjustment results in a somewhat higher wholesale financial sector GVA in those EU Member States with a large financial intermediation sector in terms of GVA relative to the overall economy.

Regarding employment, each Member State's wholesale financial sector productivity level implicit in the reports of the previous years was maintained by adjusting the wholesale employment level upward by the same proportion as the GVA level.

The size of the wholesale finance sector worldwide

Total worldwide wholesale finance is estimated at €696 billion in 2007, up 18.2 billion or 2.7% on the previous year (see Table 2).

The EU-27 wholesale finance sector, at an estimated €225 billion, is, as in previous years, the second largest in the world after the US. It grew by €9 billion, or 4.1%.

In contrast, the US wholesale finance sector is estimated at €244 billion, down from €250 billion in 2006. However, this apparent decrease in the size of the wholesale finance sector in the US is entirely due to the depreciation of the US dollar vis-à-vis the euro, however. At unchanged exchange rates, the US wholesale finance sector would have shown an increase in size in 2007.

Table 2: Estimates of wholesale finance activity at 2007 constant prices, € billion				
	1997	**2002**	**2006**	**2007**
EU-27	124.1	161.5	216.5	225.4
US	141.3	191.9	249.6	244.3
Japan	48.1	59.5	73.9	79.9
China	10.0	19.0	25.2	28.5
Rest of Asia and Pacific	21.8	33.2	42.7	44.7
Rest of Europe	16.3	22.8	28.6	29.5
Rest of world	23.9	32.2	41.7	44.1
World	**385.5**	**520.1**	**678.2**	**696.4**

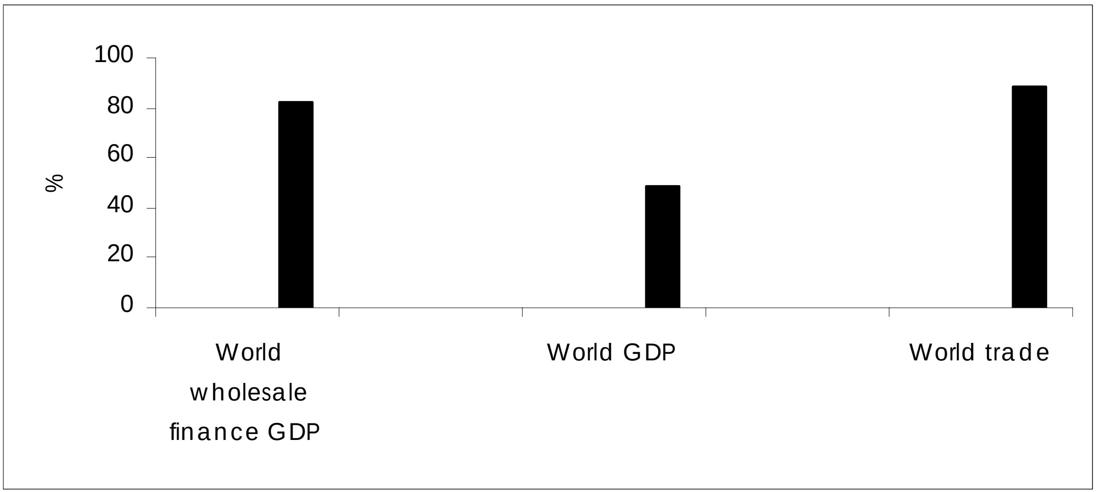
Sources: London Economics analysis based on data from Eurostat; US Bureau of Economic Analysis; Japan Statistics Bureau, Japan Statistical Yearbook 2006; National Bureau of Statistics of China, China Statistical Yearbook 2006; Groningen Growth and Economic Development Centre

Wholesale finance grew in all the other countries / regions of interest, with particularly strong growth in China (+13% in 2007) reflecting the very strong growth of the Chinese economy and the rapid development of its financial sector.

Over the period 1997 to 2007, world wholesale finance GDP (at 1997 prices) grew by 81% while world GDP (at constant prices) increased by only 49%.

It is well known that international trade (in constant prices) expanded faster than world GDP. For example, Figure 7 shows that world exports (in constant prices) increased by 88% over the period 1997 to 2007.

Figure 7: Estimates of growth in world wholesale finance GDP, world GDP and world trade 1997 to 2007



Note: World trade is measured by exports at constant prices
Sources: London Economics analysis based on world GDP and world trade data from IMF World Economic Outlook April 2008 and world wholesale finance GDP data from Table 2

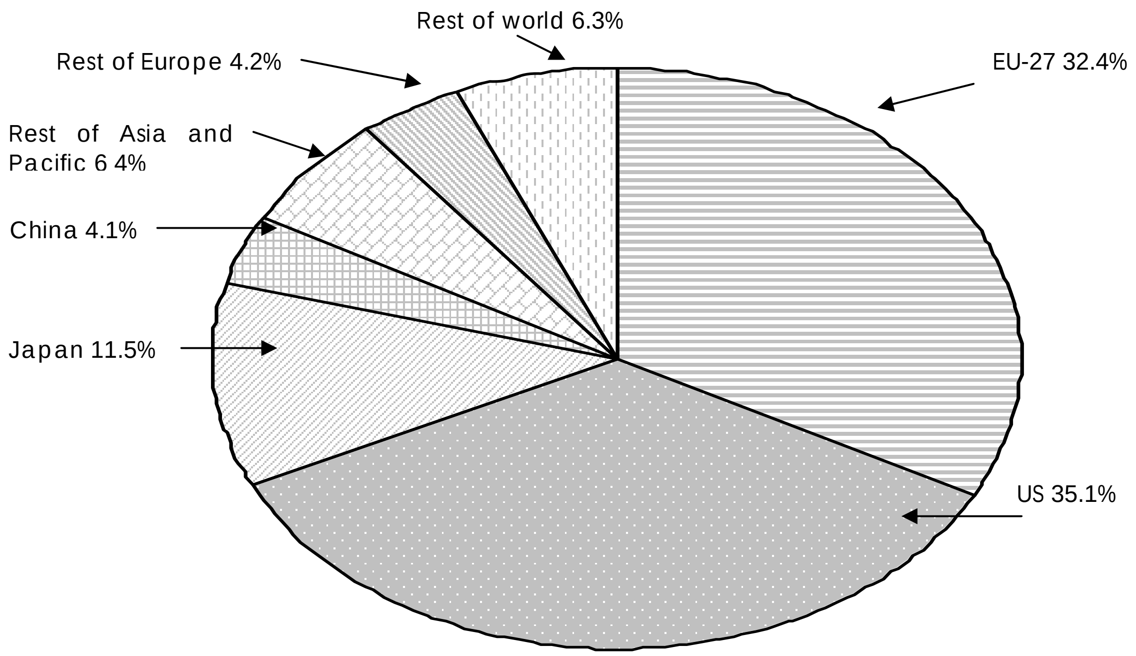
Much less known is the fact that world wholesale finance GDP also expanded much faster than world GDP. A number of factors contributed to the rapid growth in world wholesale finance GDP since 1997. These included a very significant expansion of the set of financial instruments available to traders and investors, and the growing importance of new types of financial institutions such as hedge funds, capital venture funds, etc., combined with growing appetite for financial market instruments and risk diversification.

Overall, the wholesale finance sector plays a critical role in the modern economy, and, as will be shown, is fully integrated in the globalised economy.

In 2007, the EU-27 and the US together accounted for two-thirds of the world wholesale finance sector (see Figure 8).

Among the other countries/ regions, Japan accounted for 11.5% of world wholesale finance GDP, China for 4.1%, the rest of Asia and Pacific for 6.4%, the rest of Europe for 4.2% and the rest of the world for 6.3%.

Figure 8: Estimates of shares of world wholesale finance GDP in 2007



Sources: London Economics analysis based on data from Eurostat; US Bureau of Economic Analysis; Japan Statistics Bureau, Japan Statistical Yearbook 2006; National Bureau of Statistics of China, China Statistical Yearbook 2006; Groningen Growth and Economic Development Centre

The EU-27 wholesale finance sector, which accounts for the second largest share of world wholesale finance after the US, has been gaining some, market share, albeit very small, between 2002 and 2007 (see Table 3). In contrast the US has lost some moderate market share over this period.

As a result, the gap between the EU27 and the US has narrowed from 5.9 percentage points in 2002 to 2.7 percentage points in 2007. If these recent trends were to continue into the future, the two sectors would be about equal by 2012.

Table 3: Estimates of shares of world wholesale finance GDP 1997 -2007

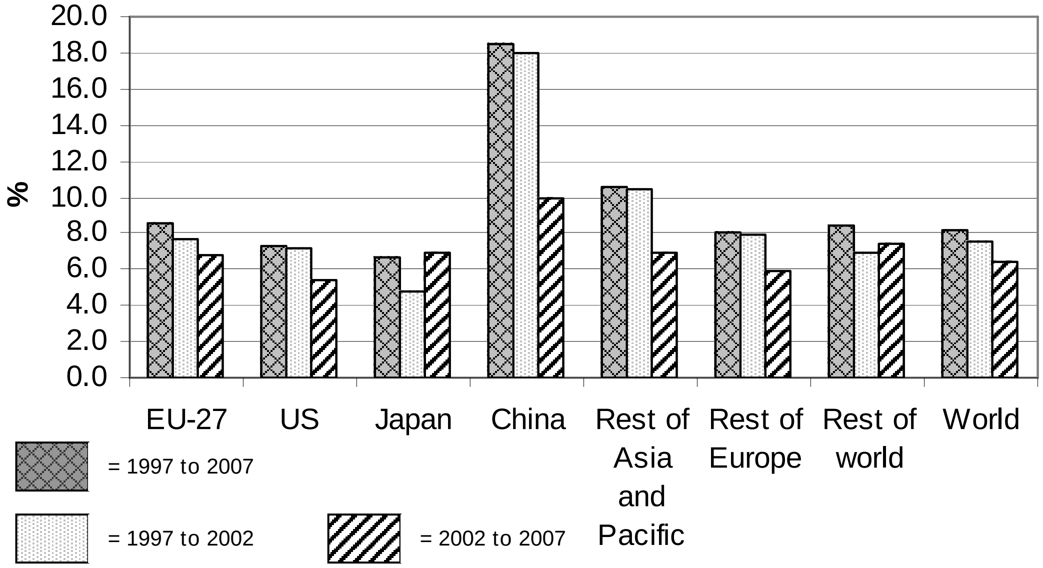
	1997	2002	2007	Direction of change of share 1997 to 2007	1997 to 2002	2002 to 2007
EU-27	32.2	31.5	32.4	-	-	+
US	36.7	36.7	35.1	=	+	-
Japan	12.5	11.4	11.5	-	-	=
China	2.6	3.6	4.1	+	+	+
Rest of Asia and Pacific	5.7	6.3	6.4	+	+	=
Rest of Europe	4.2	4.4	4.2	=	=	=
Rest of world	6.2	6.2	6.3	=	=	=

Notes: Due to rounding of figures, only changes greater than 0.2 percentage point in the world market share are considered as directional changes. "+" = increase in market share, "-" = decrease in market share, "=" = no change in market share

Sources: London Economics analysis based on data from Eurostat; US Bureau of Economic Analysis; Japan Statistics Bureau, Japan Statistical Yearbook 2006; National Bureau of Statistics of China, China Statistical Yearbook 2006; Groningen Growth and Economic Development Centre

The wholesale finance sector in China grew much more rapidly than in other countries/ regions over the last 10 years (see Figure 9), especially over the period 1997-2002. Such rapid growth reflects the fact that in China the wholesale finance sector was very small until relatively recently. As the financial needs of the Chinese economy grew and became more sophisticated, so did the wholesale financial sector.

Figure 9: Estimates of growth in world wholesale finance GDP in 1997 to 2007



Sources: London Economics analysis based on data from Eurostat; US Bureau of Economic Analysis; Japan Statistics Bureau, Japan Statistical Yearbook 2006; National Bureau of Statistics of China, China Statistical Yearbook 2006; Groningen Growth and Economic Development Centre

3.2 World equities markets

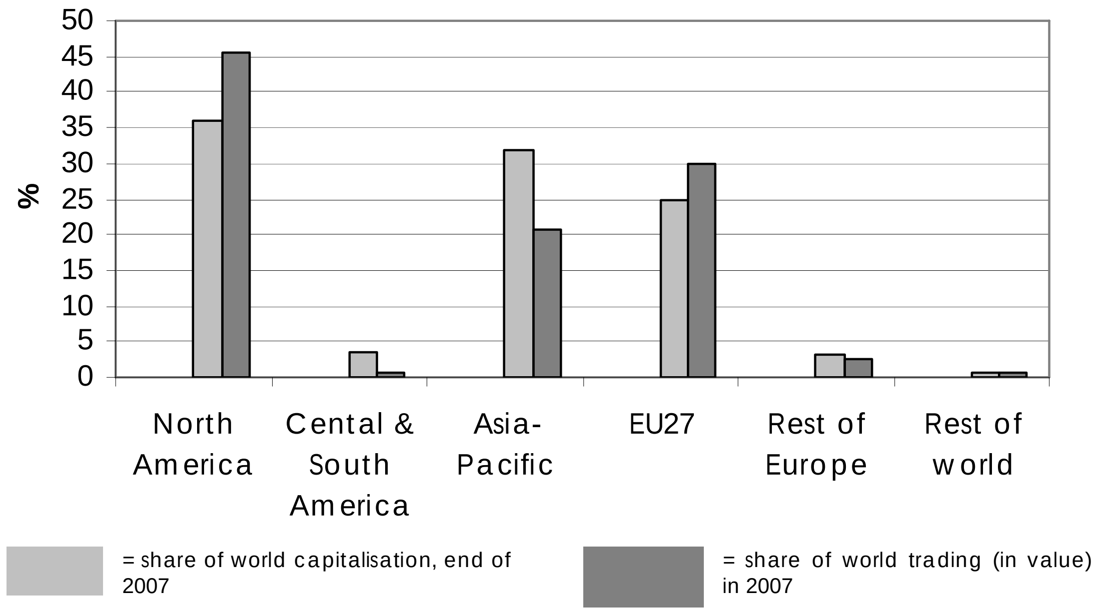
At the end of 2007, North America, the Asia-Pacific region, and the EU27 accounted for 93% of the capitalisation of all stock exchanges for which the World Federation of Exchanges reports data, and for 96% of the value of equity trading in 2007 on these exchanges (see Figure 10)[6].

These three regions, with two exceptions (the Sao Paulo Stock Exchange and the Johannesburg Stock Exchange), also host the 20 largest stock exchanges in terms of 2007 capitalisation. In 2007, these 20 stock exchanges accounted for 94% of total world capitalisation and 95% of total trading (in value). Of these 20, seven are from emerging economies (in order of importance the Shanghai Stock Exchange, the Hong Kong Exchanges, the Mumbai Stock Exchange, the National Stock Exchange of India, the Sao Paulo Stock

[6] It should be noted that the World Federation of Exchanges does not publish data on stock exchanges in Russia and other CIS States.

Exchange, the Johannesburg Stock Exchange and the Shenzhen Stock Exchange - see Table 5).

Figure 10: Distribution of world capitalisation and world exchange trading in 2007 – shares in %



Source: London Economics analysis based on data from World Federation of Exchanges

While the top 20 stock exchanges as a group experienced growth in capitalisation and trading value of more than 20%, practically all the growth in 2007 was accounted for by the exceptionally strong performance of the stock exchanges from the emerging economies. This continued a trend that has been observable over a number of years.

On average, over the last 5 years stock market capitalisation has grown almost 6 times as fast at the top stock markets from the emerging economies as at the top stock markets from the advanced economies. Growth in stock market trading (in value) shows a similar pattern although the differences between the two groups of countries are slightly less pronounced (see Table 4).

Table 4: Growth in stock market capitalisation and turnover - 2006 to 2007 and 2002 to 2007 on largest world stock exchanges

	Growth in capitalisation in %		Growth in trading (in value) in %	
	2006 to 2007	2002 to 2007	2006 to 2007	2003[1] to 2007
Emerging economies	107.7	702	161	641
Advanced economies	6.2	117	35	190
Ratio of emerging economies to advanced economies	5.8	6.0	4.8	3.4

Notes: As no trading data are available for 2002 in the database from the World Federation of Exchanges, the growth in trading value is reported for the period 2003 to 2007
Source: London Economics analysis based on data from World Federation of Exchange

Within the group of the top stock markets located in emerging economies, by far the strongest performance in terms of capitalisation was posted by the two Chinese stock markets (the Shanghai Stock Exchange and the Shenzhen Stock Exchange) and, to a somewhat lesser extent, the two Indian stock markets (the Mumbai Stock Exchange and National Stock Exchange of India). In terms of growth in trading, the two Chinese stock exchanges also posted very substantial increases of 400% and more.

As a result of the very rapid growth in recent years, the Shanghai Stock Exchange, the Hong Kong Stock Exchanges and the Mumbai Stock Exchange now figure among the top 10 stock markets in the world (see Table 5).

The rapid growth of stock market capitalisation and turnover in the major emerging markets reflects rapidly rising domestic incomes and savings in a number of such countries and large equity portfolio investments from abroad.

In 2006, China alone received more than €25.5 billion in net inward portfolio equity investment or 34% of total net inward portfolio equity investment into developing countries (see Table 6).

The other BRIC countries (Brazil, India and Russia) accounted for a further 27% of total net inward portfolio equity investment into developing countries.

Table 5: Domestic stock market capitalisation and turnover in 2007 of 20 largest stock exchanges, € billion

Stock exchange	Capitalisation, at year end: Level	Share of world	Growth rate 2006 to 2007 in %	Growth rate 2002 to 2007 in %	Annual trading in value: Level	Share of world	Growth rate 2006 to 2007 in %	Growth rate 2002 to 2007 in %
NYSE Group	10,638	25.79	1.5	74	21,313	31.2	34.0	201
Tokyo SE Group	2,944	7.1	-6.1	109	4,725	8.3	11.2	204
Euronext	2,870	7.0	13.9	174	4,121	5.4	48.4	196
Nasdaq	2,728	6.6	3.8	101	11,178	16.9	29.7	117
London SE	2,618	6.3	1.5	116	7,533	10.9	36.1	185
Shanghai SE	2,511	6.1	302.7	981	2,970	1.1	450.9	1490
Hong Kong	1,804	4.4	54.8	473	1,561	1.2	156.9	622
Deutsche Börse	1,431	3.5	28.6	207	3,155	3.9	57.7	231
TSX Group	1,486	3.6	28.6	277	1,203	1.8	28.5	247
Mumbai SE	1,236	3.0	122.1	1,333	254	0.3	61.7	288
BME Spanish Exchanges	1,211	2.9	34.6	286	2,168	2.8	53.0	1413
National Stock Exchange India	1,128	2.7	114.5	1,423	555	0.6	79.4	288
Sao Paulo SE	931	2.3	92.8	981	45	0.4	-77.6	-9
Australian SE	882	2.1	18.5	242	1,006	1.2	60.2	267
Swiss Exchange	864	2.1	4.8	132	1,376	2.0	35.1	210
OMX Nordic Exchange	845	2.0	10.7	291	1,360	1.9	39.8	246
Korea Exchange	763	1.8	34.5	420	1,467	1.9	50.1	338
Borsa Italiana	729	1.8	4.5	125	1,687	2.3	44.8	181
JSE	563	1.4	16.4	355	310	0.4	36.2	316
Shenzhen SE	533	1.3	244.2	356	1,534	0.6	396.2	1399
Total 20 stock exchanges	**38717**	**93.8**	**20.6**	**164**	**69,522**	**95.3**	**43.2**	**214**
Total - world	**41254**	**100.0**	**17.6**	**171**	**73,270**	**100.0**	**43.8**	**210**

Source: London Economics analysis based on data from World Federation of Exchanges

Table 6: Net inward portfolio equity flows to developing countries, € billion

	2000	2003	2006
China	7.5	6.8	25.5
Brazil	3.4	2.7	6.1
India	2.5	7.2	6.9
Russia	0.2	0.4	7.3
Other East Asia and Pacific	-0.3	4.2	13.1
Other South Asia	0.1	0.2	1.0
Other Latin America and the Caribbean	-4.0	0.4	2.7
Other Europe and Central Asia	0.4	-0.9	1.0
Middle East and North Africa	0.2	0.3	1.3
Sub-Saharan Africa	4.5	0.6	10.0

Source: World Bank, Global Development Finance 2007

3.3 The EU wholesale finance sector in the globalised economy

Last year's report on the Importance of Wholesale Financial Services to the EU economy highlighted the fact that finance and insurance trade accounted for only 1.6% of all world trade and for 11% of EU service exports.

In this report, the performance of the EU wholesale sector in international trade is examined in greater detail. This relies on the latest trade data from the World Trade Organisation (WTO). Wholesale financial services exports are defined as the sum of exports of financial and insurance services, on the assumption that exports of retail financial services are likely to be small or negligible.

Before analysing the export performance of the wholesale finance sector in greater detail, it is useful to briefly take note of the distribution of net savings and the associated current account surpluses/deficits across the globe. These current account balances are mirror images of the difference between domestic savings and domestic investment. Whenever the latter exceeds the former, the deficit in domestic savings is filled by an inflow of foreign savings and the wholesale finance sector plays a crucial role in supporting and facilitating this transfer of savings.

As the table below shows, the net external position of the economies with significant wholesale finance activities varies greatly.

Table 7: Current account balances, € billion								
Country/region	**Year**							
	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
EU-27	-91.2	-30.5	20.2	18.5	50.6	-24.1	-75.9	-133.2
Rest of Europe	59.0	51.6	48.0	59.2	61.4	73.8	84.1	89.5
US	-451.9	-429.5	-486.0	-461.5	-514.6	-606.8	-646.3	-624.6
Japan	129.5	98.0	119.1	120.4	138.4	133.2	135.7	156.0
China + Hong Kong	29.8	30.4	50.6	55.1	67.8	145.5	215.4	320.1
Korea, Singapore and Taiwan	34.5	42.7	45.6	56.2	54.8	47.9	53.4	54.2
Middle East	77.6	44.6	32.1	52.1	77.7	158.1	186.2	180.8
CIS	52.2	37.0	31.9	31.7	51.0	71.0	78.4	61.5
Rest of the world	-33.7	-27.1	-1.7	13.0	5.6	6.7	38.4	-29.8
Total - savings exporters (i.e. with current account surpluses)	**382.6**	**304.3**	**347.5**	**406.2**	**507.3**	**636.2**	**791.7**	**862.2**
Total – savings importers (i.e. with current account deficits)	**-576.8**	**-487.1**	**-487.8**	**-461.5**	**-514.6**	**-630.9**	**-722.2**	**-787.6**
Errors and omissions	-194.1	-182.8	-140.3	-55.3	-7.3	5.3	69.4	74.5

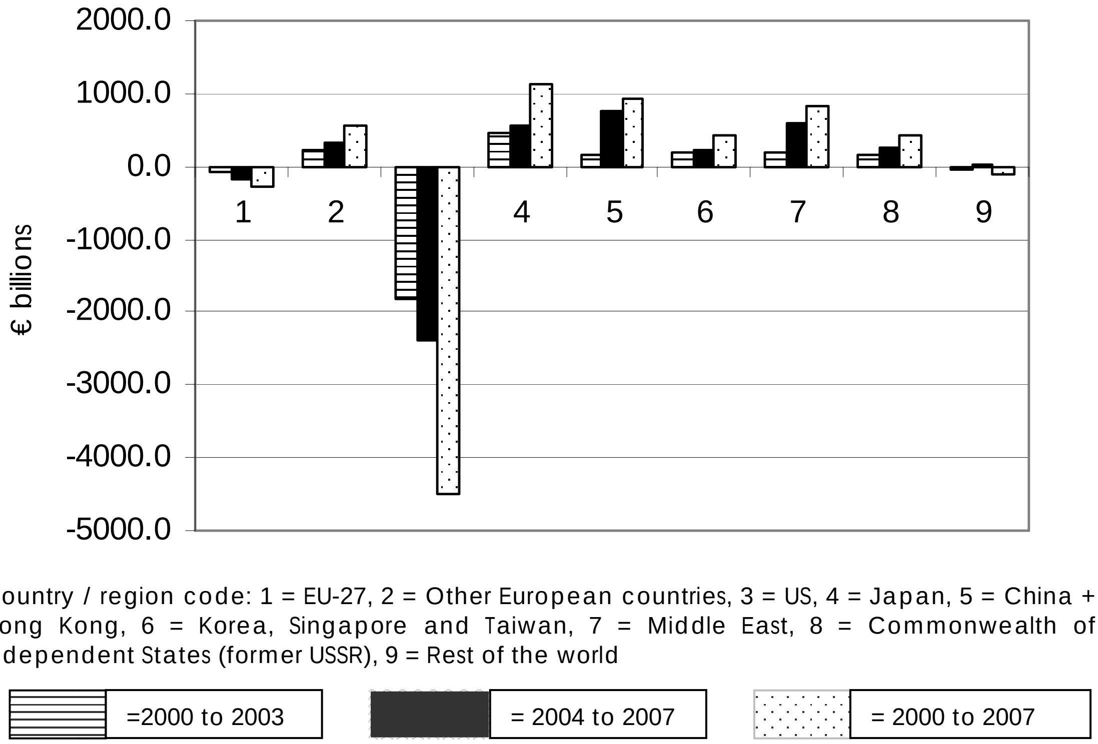
Note: Data for 2007 are estimates
Source: London Economics analysis based on data from IMF World Economic Outlook databank

Throughout the period 2000 – 2007, the US systematically imported vast amounts of savings from the rest of the world. In fact, depending on the year, the US accounted for between 75% and 100% of total worldwide net savings imports.

In contrast, the position of the EU-27 changed from being a savings importer in 2000 and 2001 to being a savings exporter from 2002 to 2004 and then becoming again a savings importer. The quantity of world savings absorbed by the EU-27, however, is much smaller than the US draw on such savings, however, and fluctuates between 20% and 30% of total savings imports.

All the other countries / regions of interest (with the exception of the rest of the world region) were systematically savings exporters. Within this set, the increasing contribution of China and Hong Kong, Korea, Singapore and Taiwan, and the Middle East are particularly noteworthy.

Figure 11: Cumulative net savings exports and imports 2000 - 2007



Country / region code: 1 = EU-27, 2 = Other European countries, 3 = US, 4 = Japan, 5 = China + Hong Kong, 6 = Korea, Singapore and Taiwan, 7 = Middle East, 8 = Commonwealth of Independent States (former USSR), 9 = Rest of the world

Note: Data for 2007 are estimates
Source: London Economics analysis based on data from IMF World Economic Outlook databank.

It is worth noting that the level of activity in the wholesale sector obviously depends on many other factors, including gross rather than net capital flows between countries.

In 2005, the last year for which data are available, the EU-27 exported almost €100 billion worth of wholesale financial services. This is almost three times as much as the United States, the second largest exporter of wholesale finance services (see Table 8). As a result, the EU27 accounted for 55% of world exports of wholesale finance whereas the US's market share of wholesale finance exports was only 19%.

The other major exporters of financial services, according to the WTO data, were: Japan (2.7% market share of world exports of wholesale finance); China and Hong Kong (3.0%); Singapore (2.2%); Canada (0.5%); Australia (2.2%); Russia (0.5%); and other European countries (including Switzerland) (8.2%).

About three-quarters of total EU-27 wholesale finance exports were in financial services and one-quarter were in insurance services.

While the EU mix of financial and insurance services exports is very similar to that of the world as a whole, a number of countries / regions are much more dependent on insurance services exports than the EU-27 (e.g., other European countries, Canada, Australia and Russia) while the US, Japan, and China + Hong Kong, are much more dependent on financial services for the exports of wholesale finance services.

Table 8: World exports of wholesale finance by major exporter in 2005

Country / region	Exports of financial services, € billion	Exports of insurance services, € billion	Total exports of wholesale finance, € billion	Country's/ region's share in world exports of wholesale finance	Country's / region's share of financial services exports in the country's total exports of wholesale finance
EU-27	77.1	19.5	96.6	54.7	79.0
Other European countries	9.6	4.8	14.5	8.2	66.7
US	27.4	5.5	32.9	18.8	83.4
Japan	4.0	0.7	4.7	2.7	84.7
China + Hong Kong	5.1	0.3	5.4	3.0	94.0
Singapore	3.0	0.9	3.9	2.2	77.1
Canada	0.6	0.4	1.0	0.5	58.3
Australia	1.3	2.6	3.9	2.2	33.3
Russia	0.6	0.4	1.0	0.5	58.3
Rest of the world	8.0	5.1	13.0	7.4	61.1
Total	**136.6**	**40.2**	**176.7**	**100.0**	**77.3**

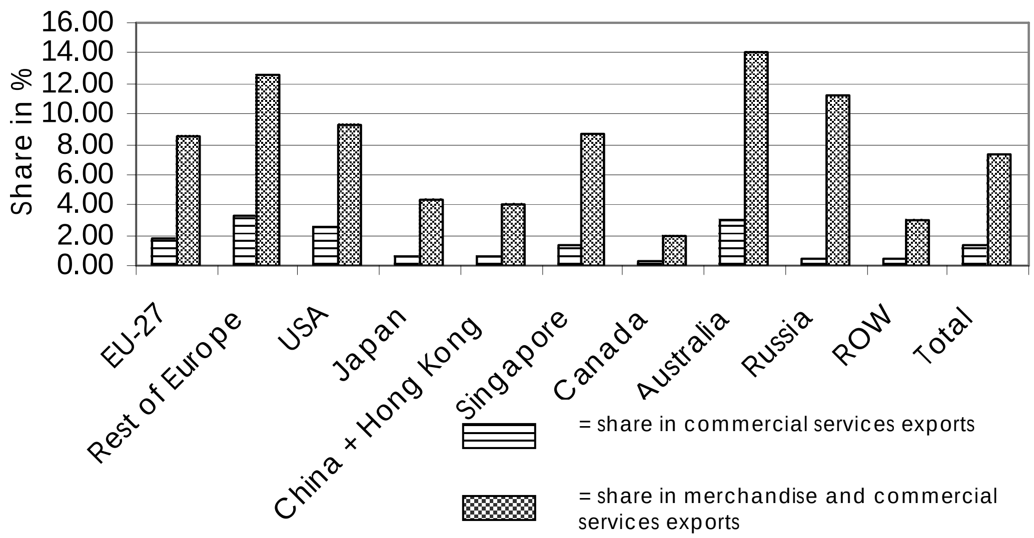
Source: London Economics analysis based on data from WTO International Trade Statistics 2007

Although the EU-27's world share of exports of wholesale finance services is by far the largest in the world, such exports account for only 1.9% of total EU-27 merchandise and commercial services exports. This is somewhat less than in the US (2.6%) and the rest of Europe (3.8%) but considerably more than in all other countries except Australia.

The contribution of wholesale finance exports to EU-27 commercial service exports (at 8.6%) is more than four times as high as that to the combined merchandise and commercial services exports (1.9%).

In this regard, it should be noted that a number of countries / regions, such as the rest of Europe, the US, Singapore and Australia, depend to a much greater degree on exports of wholesale finance services for their commercial services exports, even though the level of their exports of such wholesale finance services pales against that of the EU-27. This reflects the fact that the overall level of EU-27 commercial services exports is much higher than in these regions /countries.

Figure 12: Share of wholesale finance services exports in total exports and commercial services exports.



Source: London Economics analysis based on data from WTO International Trade Statistics 2007

While 43% of EU-27 exports of wholesale finance services are intra-EU27 exports, the EU-27 nevertheless remains the top exporter of wholesale finance services to destinations outside the EU-27 (see Table 9). At €41.8 billion in 2005, the value of such EU-27 exports is almost 30% higher than that of similar US exports.

Table 9: Exports of wholesale finance by the EU-27 and the US in 2005
Level of exports in € million and top 10 export markets

EU-27		US	
Value in 2005 (€ million)	**96,674**	**Value in 2005 (€ million)**	**32,864**
of which			
Within EU 27	54,862		
Outside EU 27	41,812		
Share of total EU-27 wholesale finance exports of top 10 markets outside EU-27		**Share of total US wholesale finance exports of top 10 markets**	
Country	Share in %	Country	Share in %
United States	28.7	EU-27	36.9
Switzerland	14.9	Canada	6.3
Japan	8.1	Switzerland	6.2
China + Hong Kong	3.9	Japan	4.8
Canada	2.7	Australia	2.3
Australia	2.2	China + Hong Kong	2.1
Norway	2.0	Switzerland	1.9
Russia	2.0	Mexico	1.7
Singapore	1.3	Brazil	1.2
Korea	1.0	Korea	1.0
Total top 10 markets	**66.8**	**Total top 10 markets**	**64.4**
Rest of the world	33.2	Rest of the world	35.6

Source: London Economics analysis based on data from WTO International Trade Statistics 2007

The EU-27 and the US are each other's major trading partner for wholesale financial services, with the EU-27 being much more important to the US as an export market (accounting for 37% of US exports) than the US to the EU-27 (accounting for 29% of EU-27 exports).

In both cases, exports of wholesale finance services are heavily concentrated in a few destinations countries / regions, with the top three export markets accounting for about 55% of all financial service exports (see Figure 13).

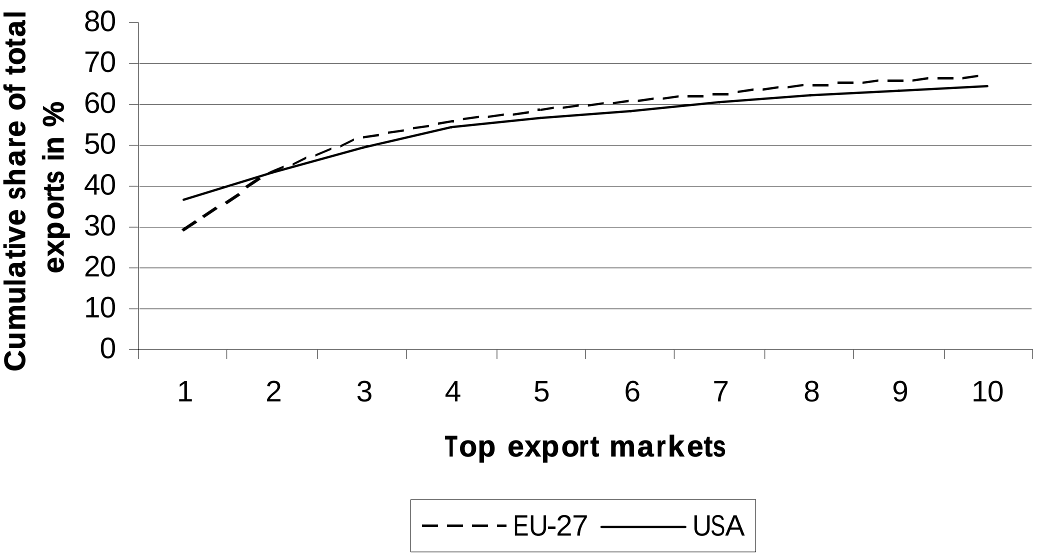
Overall, there is relatively little difference among top export markets with:

- Japan;
- Switzerland;
- China and Hong Kong;
- Canada;
- Australia; and
- Korea;

being among the top-10 wholesale finance export markets of both the EU-27 and the US.

The only notable differences are that the EU-27 counts also a number of other European markets (Norway and Russia), and Singapore among its top export markets while the US counts a few Central and South American markets (Mexico, Brazil), as top destinations for exports of wholesale finance services.

Figure 13: Cumulative share of wholesale finance exports by major export markets by the EU-27 and US in 2005



Source: London Economics analysis based on data from WTO International Trade Statistics 2007

3.4 Conclusions: a strong wholesale finance sector in the EU27 which is fully integrated into the world economy

This chapter demonstrates that:

- The EU-27-wholesale finance sector is the second largest in the world after the US sector;
- The current account imbalances characterising the world economy result in very large international savings flows, one of the many factors driving the level of wholesale finance activity; and,
- The EU-27 is the top world exporter of wholesale finance services.

The next chapter will examine the contribution of the wholesale finance sector to GDP and employment at the EU-27 level and the Member State level. It will also review developments in individual sub-sectors of the EU wholesale finance sector.

4 The European Wholesale Financial Services Sector

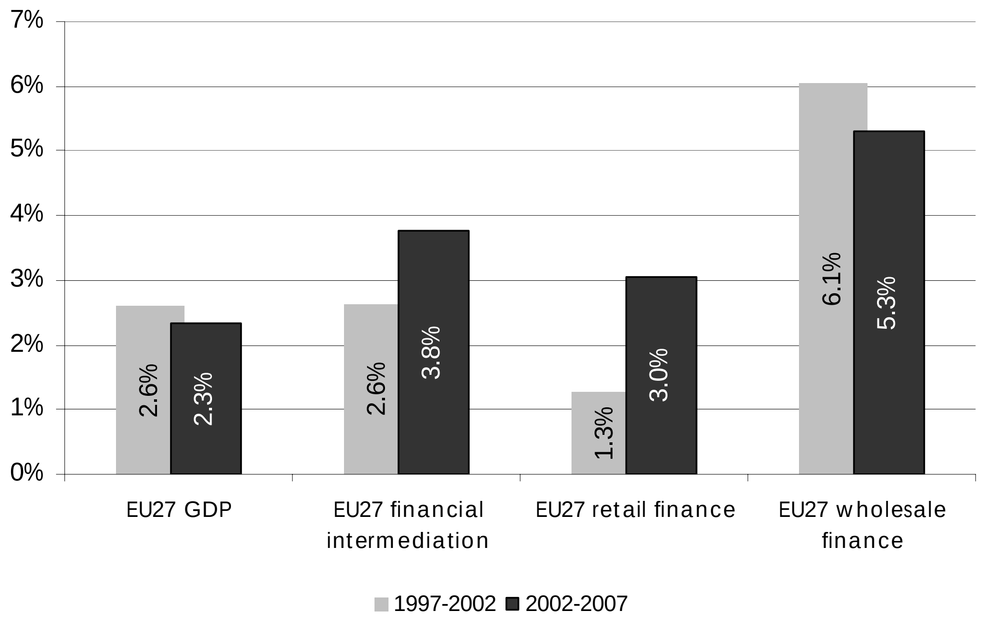
This chapter first provides information on the size of the wholesale financial services sector in each EU-27 Member State in terms of output (GVA) and employment, and reviews the contribution of the sector to economy-wide growth in output, employment and labour productivity. It then goes on to take stock of the degree of Single Market integration of the sector.

4.1 The economic contribution of the European wholesale financial sector

Gross value added

Over the last five years, the wholesale financial sector (as measured by GVA) in the 27 EU Member States grew more than twice as rapidly as the economy as a whole, expanding, on average, by 5.3% each year while total GDP grew by 2.3% per cent year over the same period (see Figure 14).

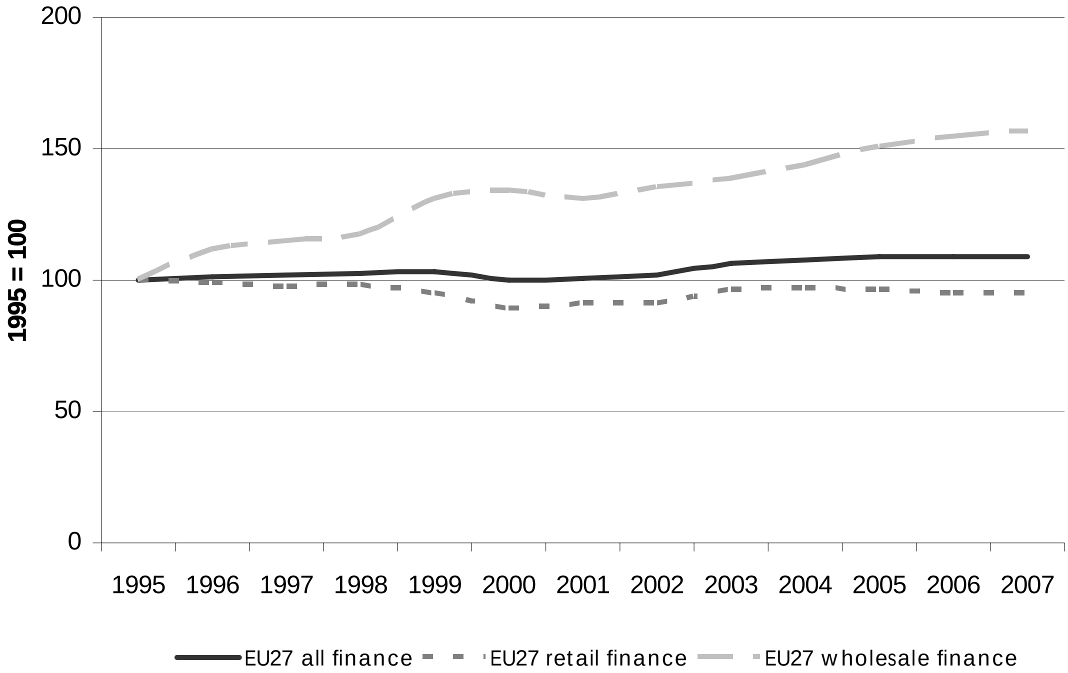
Figure 14: Average annual real growth in EU27 economy and financial sectors 1997-2007



Source: London Economics analysis based on Eurostat data

The EU27 wholesale financial sector also grew faster than the retail financial sector, especially over the period of 1997 to 2002. During this period, the retail financial sector's share of GVA in economy-wide expanded only very slowly, and actually reduced marginally in size in 1999 and 2000 (see Figure 15). In contrast, the EU27 wholesale financial sector has expanded almost steadily since 1996, and its share of economy-wide GVA now stands more than 50% higher than in 1996.

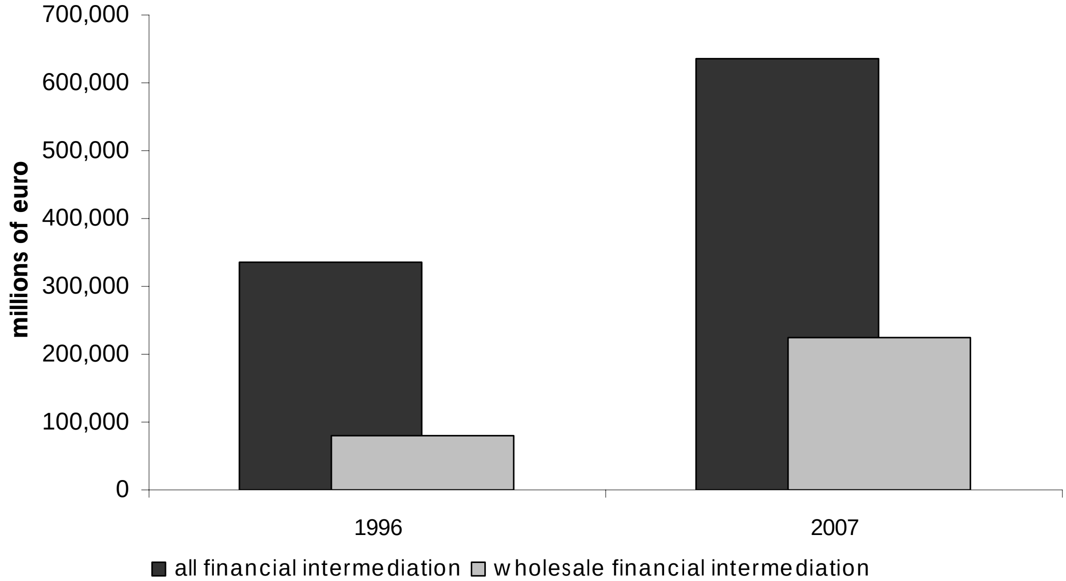
Figure 15: Financial intermediation as a share of EU-27 GDP



Source: London Economics analysis based on Eurostat data

As the EU27 wholesale financial sector grew faster than the EU27 retail finance sector, its share of total financial intermediation services increased from 31% in 1996 to 37% in 2007 and its GVA stood at €225 billion in 2007 while total financial intermediation GVA reached €628 billion (both at 2007 prices).

Figure 16: Financial intermediation in EU-27

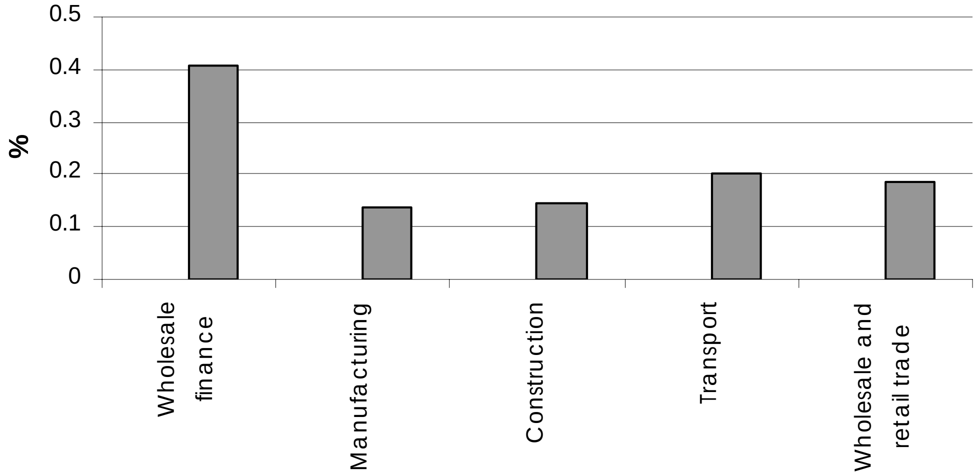


Source: London Economics analysis based on Eurostat data

The data presented so far have shown that wholesale finance GVA expanded more rapidly than economy-wide GVA and total financial sector GVA.

In fact, the wholesale finance sector expanded more rapidly in recent years than most other sectors of economic activity. Indeed, of the five sectors represented in Figure 17, the wholesale financial sector has been the fastest growing since 2000.

Figure 17: Cumulative growth in GVA (at constant prices) in selected sectors, 2000 to 2007



Source: London Economics analysis based on Eurostat data

So far, the report has focused on developments in EU27 wholesale finance GVA. Estimates of the size of the wholesale financial sector (in terms of GVA at 2007 prices) in each of the 27 EU Member States are provided In Table 10.

Relative to the size of the domestic economy, the largest wholesale financial sector, is in Luxembourg where it accounts for an estimated 21.5% of total domestic GVA. The second largest wholesale financial sector (again, relative to the domestic economy) is in Ireland. Other countries with relatively large wholesale financial sectors (as a proportion of total domestic GVA) include Belgium, Denmark, the Netherlands and the UK.

In absolute terms, the UK wholesale financial sector is by far the largest, accounting for more than one-third of EU27 wholesale finance GVA (at 2007 prices). Germany has the second largest wholesale finance sector (12.6% of EU27 wholesale finance GVA), followed by France, the Netherlands and Belgium (see Figure 18).

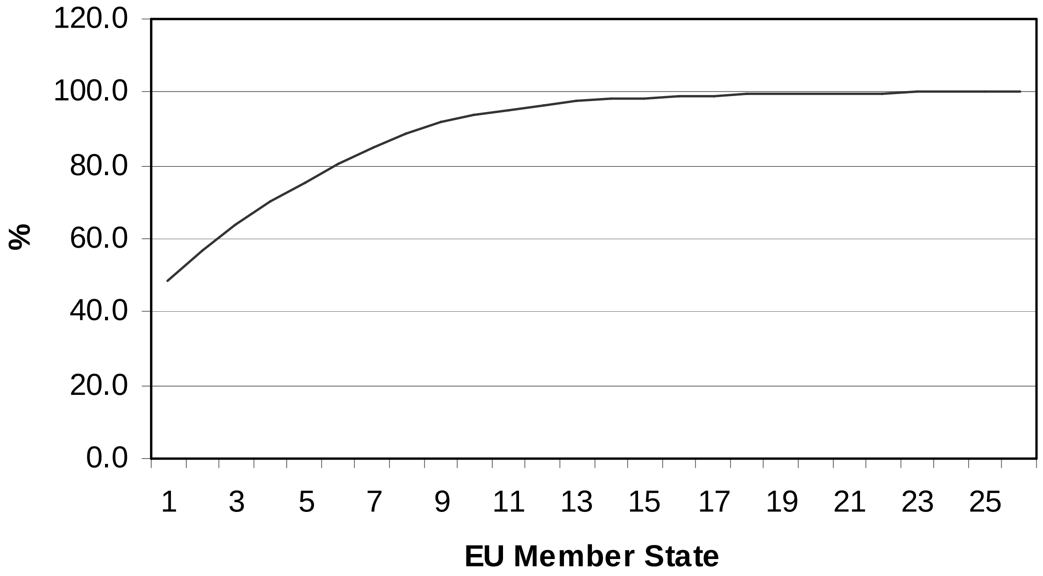
These 5 Member States accounted for 70% of EU27 wholesale finance GVA in 2007. The next five largest Member States (Ireland, Spain, Denmark, Italy and Luxembourg) accounted for another 22% of EU27 wholesale finance GVA in 2007 and the ten Member States together accounted for 92% of total EU27 wholesale finance GVA.

Table 10: Estimates of wholesale finance contribution to GDP, 2007

	Wholesale financial intermediation (€ billion), 1996	Wholesale financial intermediation (€ billion), 2001	Wholesale financial intermediation (€ billion), 2007	Country share of EU27 wholesale finance, 2007	Wholesale finance as a share of country GDP, 2007
Austria	5.2	3.6	4.1	1.8%	1.6%
Belgium	7.3	10.1	13.3	5.9%	4.5%
Bulgaria	0.2	0.2	0.2	0.1%	0.7%
Cyprus	0.1	0.4	0.4	0.2%	2.6%
Czech Rep.	0.3	0.3	0.3	0.1%	0.3%
Denmark	3.2	3.8	9.4	4.2%	4.9%
Germany	29.0	30.7	28.4	12.6%	1.3%
Estonia	0.0	0.0	0.3	0.1%	2.0%
Greece	0.3	0.8	1.9	0.9%	1.1%
Finland	0.6	0.4	0.6	0.2%	0.4%
France	1.3	13.9	19.3	8.6%	1.2%
Ireland	2.5	4.3	12.3	5.4%	7.5%
Italy	6.6	8.5	8.5	3.8%	0.6%
Hungary	0.4	0.3	0.7	0.3%	0.9%
Latvia	0.1	0.1	0.1	0.1%	0.4%
Lithuania	0.1	0.1	0.1	0.0%	0.5%
Luxembourg	3.7	4.9	7.3	3.2%	21.5%
Malta	0.0	0.0	0.0	0.0%	0.2%
Netherlands	10.3	11.5	16.2	7.2%	3.3%
Poland	0.8	1.2	1.4	0.6%	0.5%
Portugal	1.2	2.2	2.7	1.2%	1.9%
Romania	0.7	0.7	0.7	0.3%	0.7%
Slovenia	0.2	0.2	1.0	0.4%	3.4%
Slovakia	0.1	0.1	0.2	0.1%	0.3%
Spain	6.4	8.8	11.7	5.2%	1.2%
Sweden	1.9	2.9	3.8	1.7%	1.3%
UK	34.3	51.6	80.6	35.8%	4.2%
EU 27	**116.9**	**161.5**	**225.4**	**100.0%**	**2.0%**

Source: London Economics analysis based on Eurostat data

Figure 18: Cumulative share of EU27 wholesale financial sector GVA 2007



Notes: 1= United Kingdom, 2 = Germany, 3 = France, 4 = Netherlands, 5 = Belgium, 6 = Ireland, 7 = Spain, 8 = Denmark, 9 = Italy, 10 = Luxembourg, 11 = Austria, 12 = Sweden, 13 = Portugal, 14 = Greece, 15 = Poland, 16 = Slovenia, 17 = Hungary, 18 = Romania, 19 = Cyprus, 20 = Finland, 21 = Bulgaria, 22 = Czech Republic, 23 = Estonia, 24 = Slovakia, 25 = Latvia, 26 =Lithuania, 27 = Malta
Source: London Economics analysis based on Eurostat data

The wholesale financial sector GVA grew markedly in a number of EU27 Member States. For example, in the UK it is estimated to have increased by 135% from 1996 to 2007 and in Ireland by almost 400% over the same period.

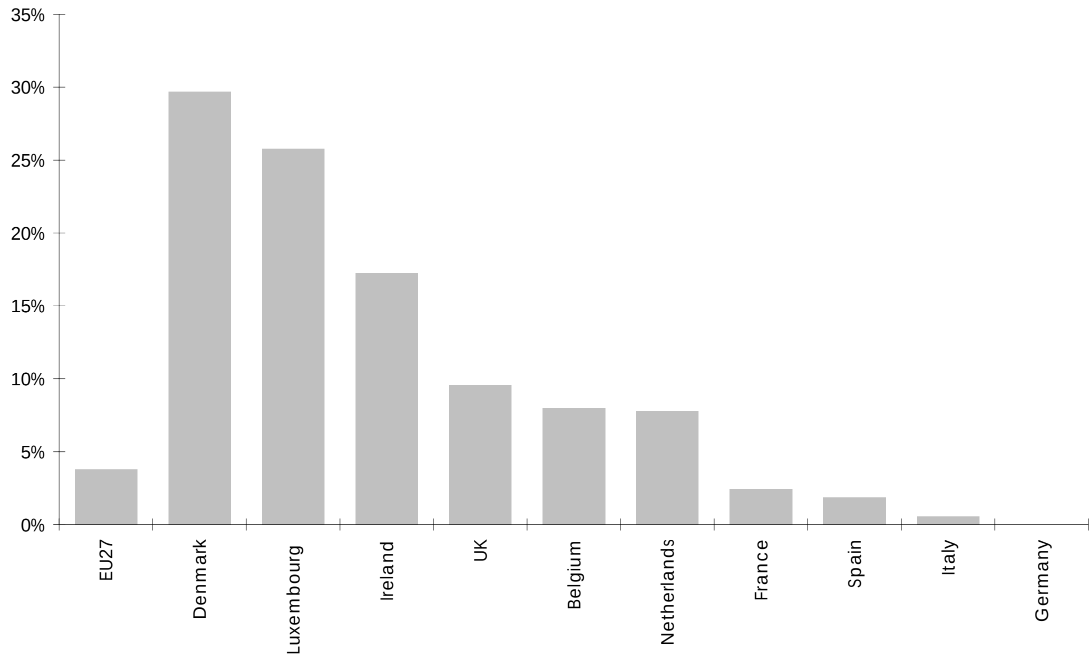
Whilst in general growth in wholesale finance GVA was strong in most of the EU27 Member States, the sector is small in many of the countries relative to economy-wide GVA. In such countries, even a very rapid expansion of the wholesale finance sector would not have a sizeable impact on economy-wide growth.

Figure 19 therefore provides an estimate of the contribution of the growth in wholesale finance GVA to the growth in economy-wide GVA over the period 2000-2007 for the 10 Member States with the largest wholesale finance sectors and for the EU27.

This contribution to economy-wide growth is equal to the product of the wholesale finance sector's share of economy-wide GVA in 2000 and the growth in wholesale finance GVA over the period 2000-2007.

Overall, EU27 economy-wide GVA grew by an estimated 15% from 2000 to 2007 and the wholesale finance sector accounted for 0.6 percentage point of the 15-per-cent increase in EU27 GVA. In all Member States showing a large contribution of the wholesale finance sector to overall economic growth, the strong growth in wholesale finance explains the sector's strong contribution to economy-wide growth.

Figure 19: Contribution of output growth in wholesale financial services to economy-wide output growth 2000-2007



Source: London Economics analysis based on Eurostat data

Employment

EU27 employment in the wholesale finance sector is estimated at 1.4 million in 2007. This figure is higher than in the previous reports on the contribution of the EU wholesale financial services because the industry's output level has been adjusted upwards while the productivity level has not been changed. The five Member States with the largest wholesale finance sectors (in terms of GVA) account for 60% of all EU27 jobs in the wholesale finance sector; the next group of 5 countries accounts for another 19% of such jobs at the EU27 level (see Table 11).

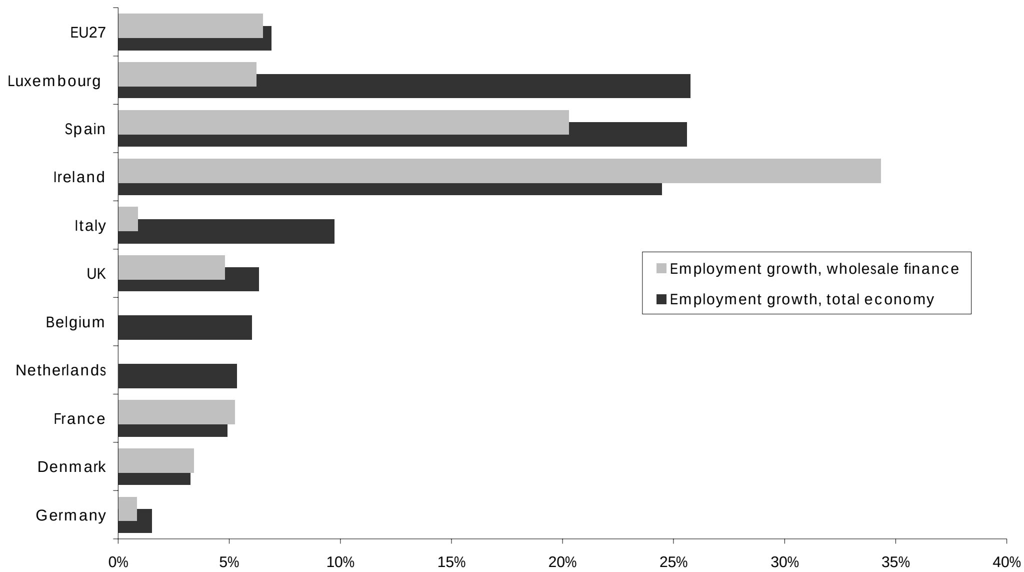
Table 11: Jobs in wholesale financial services in the EU, thousands					
	Jobs in wholesale finance, 2000	Jobs in wholesale finance, 2003	Jobs in wholesale finance, 2007	Annual job growth, 2000-2003	Annual job growth, 2003-2007
Austria	32.5	30.5	33.4	-2.1%	2.3%
Belgium	68.4	64.2	63.0	-2.1%	-0.5%
Bulgaria	12.0	11.7	15.3	-0.8%	6.9%
Cyprus	3.3	3.4	3.9	1.4%	3.2%
Czech Rep.	9.0	8.6	8.3	-1.5%	-0.7%
Denmark	53.9	54.4	55.8	0.3%	0.6%
Estonia	4.4	4.2	5.3	-1.2%	5.8%
Finland	7.5	7.4	9.0	-0.5%	5.0%
France	92.9	91.2	97.8	-0.6%	1.8%
Germany	175.7	176.5	177.1	0.2%	0.1%
Greece	13.7	13.1	16.6	-1.4%	6.2%
Hungary	24.0	21.0	22.8	-4.4%	2.1%
Ireland	43.2	44.6	58.0	1.1%	6.8%
Italy	47.6	47.7	48.0	0.1%	0.1%
Latvia	1.5	1.8	2.8	5.7%	11.9%
Lithuania	5.4	6.4	7.4	5.7%	4.0%
Luxembourg	13.3	14.7	14.1	3.6%	-1.1%
Malta	0.2	0.2	0.2	0.0%	0.8%
Netherlands	93.8	90.2	93.7	-1.3%	1.0%
Poland	40.4	37.6	42.8	-2.3%	3.3%
Portugal	41.6	37.4	45.0	-3.5%	4.7%
Romania	33.0	32.6	43.2	-0.4%	7.3%
Slovenia	10.2	10.5	12.3	0.8%	4.0%
Slovakia	5.7	6.3	7.8	2.9%	5.8%
Spain	66.8	65.3	80.4	-0.7%	5.3%
Sweden	24.9	28.4	27.0	4.5%	-1.3%
UK	355.2	332.3	372.2	-2.2%	2.9%
EU-27	**1280.0**	**1242.2**	**1363.3**	**-1.0%**	**2.4%**

Source: London Economics analysis based on Eurostat data

Among the ten Member States with the largest wholesale financial sectors in the EU27, Ireland recorded the strongest employment growth in wholesale financial services over the period 2000-2007, followed by Spain. Ireland is also the only Member State in this group where employment in wholesale finance expanded significantly more than economy-wide. At the other end of the spectrum, Belgium and the Netherlands show no growth in wholesale finance employment (see Figure 20).

The wholesale finance sector accounted for almost 0.4 percentage point of the 7-per-cent increase in EU27 employment over the period 2000-2007. In the UK, growth in wholesale finance employment accounted for about a full percentage point of the total increase in employment over the same period.

Figure 20: Employment growth in the total economy and in the wholesale finance sector, 2000-2007



Source: London Economics analysis based on Eurostat data

Labour productivity

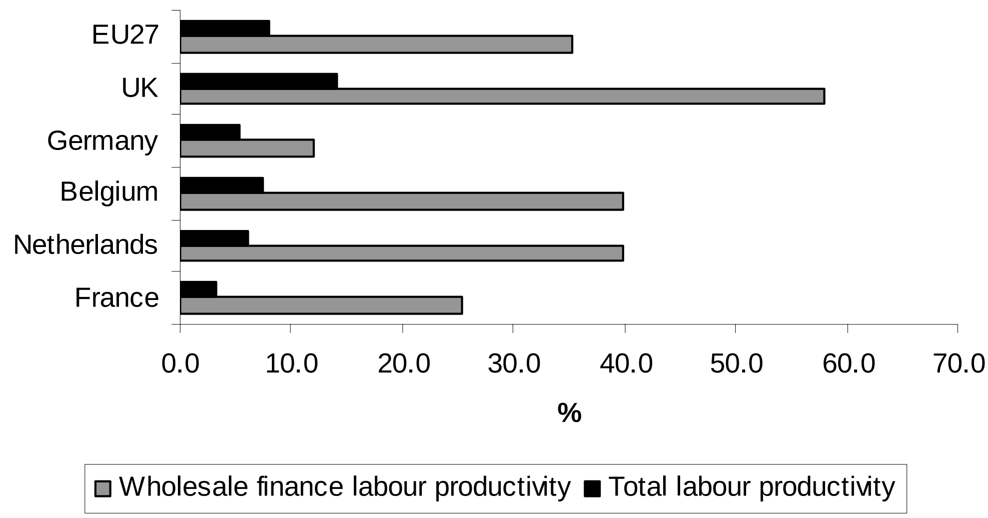
Last year's report on *The Importance of Wholesale Financial services to the EU Economy* highlighted the fact that all but one of the EU25 Member States covered by the analysis, showed higher labour productivity levels in wholesale financial services than for the economy at large.

In fact, in 12 of the 25 Member States, the labour productivity level was estimated to be at least twice as high in the wholesale financial service sector than in the overall economy, and in the case of the UK the wholesale financial sector productivity level was estimated to be more than three times as high.

The present report builds on the previous analysis, and presents and compares labour productivity growth in the countries with the largest wholesale finance sector with economy-wide labour productivity growth.

As can be seen from Figure 21, labour productivity growth grew substantially in the wholesale finance sector in most of the countries over the period 2000 – 2007, with cumulative labour productivity growth of between 10% and 60% being recorded by the five largest wholesale financial sectors in the EU27.

Figure 21: Productivity growth in the total economy and in the wholesale finance sector, 2000-2007



Source*: London Economics analysis based on Eurostat data*

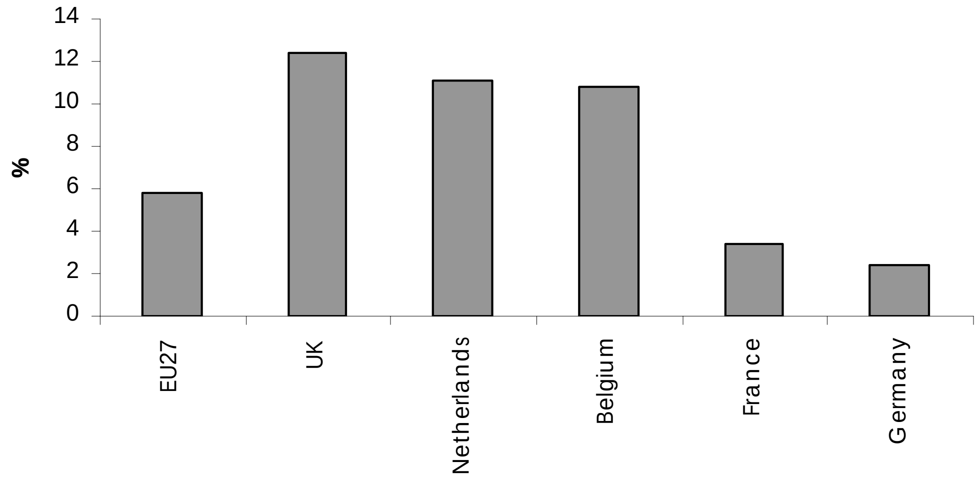
Moreover, the cumulative increase over the period 2000-2007 in labour productivity in the wholesale finance sector in the countries with the five largest wholesale financial sectors in the EU27 was two to four times as large as the cumulative increase in economy-wide labour productivity.

Thus, through the first seven years of the current decade, the wholesale finance sector made a very significant contribution to economy-wide labour productivity growth.

In fact, the wholesale finance sector accounted for 5.5 percentage points of the 9.5% cumulative increase in EU27 economy-wide cumulative labour productivity from 2000 to 2007.

In the UK, the contribution was even more marked, with the wholesale finance sector accounting for 12 percentage points of the economy-wide cumulative labour productivity growth over the period 2000 - 2007 (see Figure 22). Belgium and the Netherlands registered similarly large contributions of the wholesale finance sector to overall labour productivity growth between 2000 and 2007.

Figure 22: Contribution of productivity growth in wholesale financial services sector to economy-wide productivity growth, 2000-2007



Source: London Economics analysis based on Eurostat data

4.2 The wholesale finance sector and European integration

The Lisbon Strategy, adopted in March 2000 by the Lisbon European Council, aimed to build the EU into:

> *"The most competitive and dynamic knowledge based-economy in the world, capable of sustainable economic growth, with more and better jobs and greater social cohesion".*

This strategy was reinvigorated and strengthened by the Spring European Council in March 2005 in a renewed Lisbon Strategy which identified four priority action areas for Member States and the European Commission, namely[7]:

---

[7] See, for example, European Commission, *Performance in the Member States: "Time to Move Up A Gear" The European Commission's 2006 Annual Progress Report on Growth and Jobs*, Brussels, 25 January 2006.

- Investing more in knowledge and innovation;
- Unlocking the business potential, particularly of SMEs;
- Responding to globalisation and ageing; and,
- Moving towards an efficient and integrated EU energy policy.

To ensure that European financial markets worked as efficiently as possible in support of the Lisbon Strategy, the Financial Services Action Plan 1999-2005 (FSAP) was adopted in 1999. This was put into place with a view to completing the single wholesale market, developing open and secure markets for retail financial services, ensuring the continued stability of EU financial markets and eliminating tax obstacles to financial market integration[8].

Building on the achievements of the 1999-2005 FSAP, the European Commission more recently published a White Paper on Financial Services 2005-2010 setting out its financial sector objectives for the period to 2010. These objectives aim to "*build on the FSAP to achieve an integrated, open, inclusive, competitive, and economically efficient EU financial market*"[9].

As a result of the substantial EU policy focus on the integration of European financial market, the monitoring and assessment of the actual state of integration of these markets has attracted considerable attention. A number of official and academic studies and reports have examined this issue, focusing on cross-country comparison of various financial sector price indicators, such as interest rates, and flows of various financial services and products between EU Member States.

The typical conclusion of such assessments is that "*integration is progressing across the board, although at a very different pace depending on the product, the end-user and the market*[10]". The state of integration is generally judged to be much more advanced in wholesale finance markets than in the retail finance sector.

The following sections, first review whether the degree of EU integration of financial services exports differs significantly from that of goods exports and overall services exports.

---

[8] See European Commission press communiqué IP/99/327, *Financial services: Commission outlines Action Plan for single financial market*, Brussels, 11 May 1999

[9] See the Financial Services web page of the EC DG Internal Market and Services, http://ec.europa.eu/internal_market/top_layer/index_24_en.htm

[10] See, for example, European Commission, *European Financial Integration Report 2007,* Commission Staff Working Document, SEC(2007) 1696, Brussels 10 December 2007

Next, information is presented with regard to the evolution of the EU's share of assets in the portfolio investment assets of the EU Member States.

The evolution of cross-country dispersion of equity market returns is then reviewed, and finally information on foreign ownership of credit institutions in the various Member States is given.

The 2007 report on the *Importance of Wholesale Financial Services to the EU Economy* has already documented the importance of within-EU cross-border merger and acquisitions in the EU banking sector from 2001 to 2006, which is just touched on here, and the significant volume of cross-border inter-bank payments in a number of EU Member States[11].

4.2.1 The importance of the EU as destination for EU exports of financial services

In the case of goods exports, the proportion of an EU Member State's exports which go to theEU27 ranged in 2006 from 50.4% (Malta) to 89.5% (Luxembourg). But, for the vast majority of countries, the EU's share as a destination for goods exports fell in the range of 60% to 80% (see Table 12).

A much wider dispersion is observed in the case of financial services exports. At one end of the scale, only 2% of Latvia's exports of financial services were destined for the EU27 while, at the other end of the scale, 81% of Portugal's financial services exports were to the EU27.

Moreover, the share of exports of financial services to the EU27 in total financial services exports shows a much greater degree of variability across Member States than the EU share of goods exports.

Therefore, Table 12 also reports the difference between the share of goods exports to the EU27 in total goods exports and the share of financial services exports to the EU27 in total financial services exports. A similar comparison between total services exports and financial services exports is also provided.

The EU Member States are almost evenly divided in terms of the EU27 concentration of their financial services exports relative to that of their goods exports.

In 2006, the EU share of financial services export was lower than the corresponding share of goods exports in 13 Member States (Austria, Belgium, Czech Republic, Estonia, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, Slovenia, Sweden and the United Kingdom).

---

[11] See City of London, *Wholesale Financial Services to the EU Economy 2007*, May 2007

Of note is the fact that this group includes a number of new Member States where the destination of financial services exports may still evolve over the coming years. It also includes a number of countries with international financial centres such as London, Luxembourg and Dublin. whose diversification of financial services exports reflects the global role these financial centres play in the world economy.

When the EU's share of services exports in a country's total services exports is used as a benchmark, 16 countries showed a lower EU27 share for financial services exports than for total services exports. These countries were Austria, Belgium, Czech Republic, Denmark, France, Hungary, Ireland, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Slovakia, Sweden and the United Kingdom.

Overall, the data reported in Table 12 suggest that the EU27 is a somewhat less important destination for financial services than for goods exports and total services exports.

Table 12: Importance of EU27 as a market for EU27 exports of goods, services and financial services 2006

	EU27 share in total goods exports	EU27 share in total services exports	EU27 share in total financial services exports	Difference between EU shares in total financial services exports and total goods exports	Difference between EU shares in total financial services exports and total services exports
Austria	72.0	76.0	68.8	-7.2	-3.2
Belgium	76.7	74.9	71.0	-3.9	-5.7
Bulgaria	60.7	68.0	73.0	5.0	12.3
Cyprus	70.2	70.1	71.4	1.3	1.2
Czech Rep.	85.7	69.5	41.5	-28.0	-44.2
Denmark	71.1	48.9	67.2	18.3	-3.9
Estonia	65.7	72.1	66.4	-5.7	0.7
Finland	57.3	44.8	73.5	28.7	16.2
France	65.5	52.5	61.5	9.0	-4.0
Germany	63.6	54.0	71.8	17.8	8.2
Greece	63.9	53.1	74.5	21.3	10.6
Hungary	79.2	69.2	66.6	-2.6	-12.6
Ireland	63.3	55.2	38.9	-16.4	-24.5
Italy	61.2	61.8	77.3	15.5	16.1
Latvia	72.5	52.0	2.8	-49.2	-69.7
Lithuania	63.6	53.6	35.8	-17.8	-27.8
Luxembourg	89.5	74.3	70.3	-3.9	-19.2
Malta	50.4	73.9	37.9	-36.0	-12.5
Netherlands	79.2	56.2	64.2	8.0	-14.9
Poland	79.0	74.7	76.1	1.4	-2.9
Portugal	77.4	77.9	80.9	2.9	3.4
Romania	70.3	71.6	72.2	0.7	1.9
Slovenia	68.4	73.4	70.1	-3.3	1.7
Slovakia	86.9	75.0	80.2	5.2	-6.7
Spain					
Sweden	60.2	51.2	36.6	-14.6	-23.6
United Kingdom	62.9	41.1	41.1e	-21.8	-21.8
EU27 average	**67.3**	**60.9**	**57.4**	**-9.8**	**-3.5**

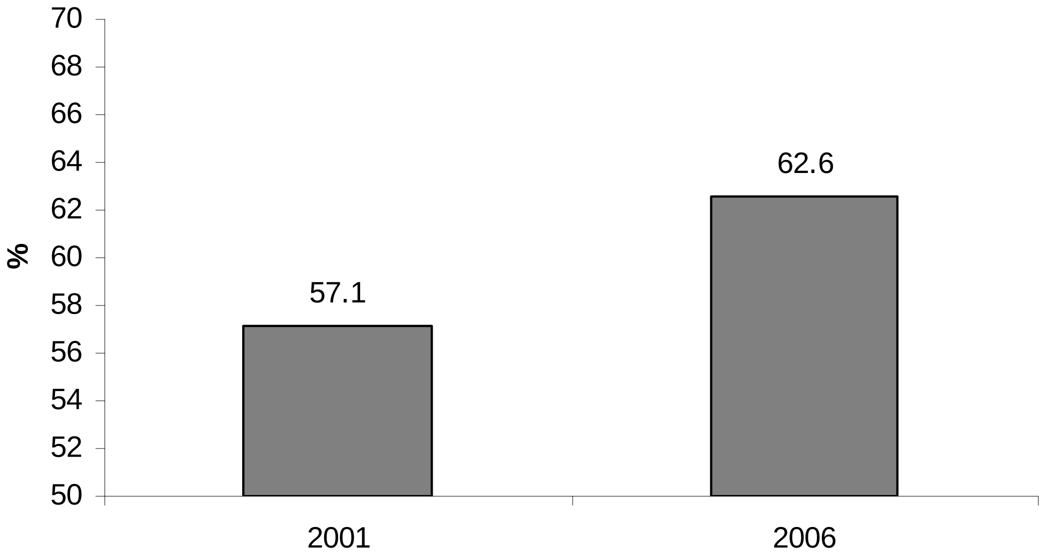
Source: London Economics analysis based on Eurostat and ONS data, London Economics estimates for the United Kingdom

4.2.2 The importance of the EU27 as a source of portfolio investment assets for EU27 residents

The IMF coordinates an annual survey of portfolio investments, the results of which can be used to assess whether EU27 residents have become more inclined over time to hold EU27 assets in their investment portfolio.

In Figure 23, we show that the share of EU27 assets in the foreign investment portfolio of EU residents has increased somewhat since 2000, from 57.1% in 2001 to 62.6% in 2006.

Figure 23: Share of EU27 portfolio investment assets in world-wide portfolio investment assets held by the EU27, at year end



Source: London Economics analysis based on results of Coordinated Portfolio Investment Survey published by the IMF

The various Member States show quite diverse movements in the share of EU assets in their residents' foreign investment portfolios, however. In fact, one can distinguish three groups of countries, namely:

- A group of 17 countries where the share increased by more than at the EU-wide level. This group comprises Austria, Belgium, Cyprus, Czech Republic, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, the Netherlands, Poland, Portugal, Romania and Sweden.

- A small group of countries where the share has also increased, but by less than at the EU level. This group comprises Denmark, Luxembourg and Spain.[12]

- A small group showing a decline in the share of EU assets in total foreign portfolio assets held by their residents. This group comprises Estonia, Malta, Slovenia and the United Kingdom. In the case of the United Kingdom, this decline in the EU share most likely reflects the growing role of London as a global financial centre.

Overall, the data show a growing focus on EU assets on the part of EU residents.

[12] Due to rounding of the figures, Spain's share does not show any change in Table 13.

Table 13: Share of EU27 portfolio investment assets in world-wide portfolio investment assets held by the EU27 Member States

	Share of assets at 2001 year end, in %	Share of assets at 2006 year end, in %	Change in share from 2000 to 2006 in percentage points
Austria	68.1	77.1	9.0
Belgium	77.5	84.8	7.4
Bulgaria	26.0	n.a.	n.a.
Cyprus	33.5	46.7	13.2
Czech Rep.	52.0	79.1	27.0
Denmark	55.8	56.6	0.7
Estonia	88.7	81.7	-7.1
Finland	73.1	80.4	7.3
France	61.5	72.5	11.1
Germany	70.0	79.1	9.1
Greece	55.7	65.9	10.2
Hungary	47.9	73.6	25.6
Ireland	45.1	56.8	11.8
Italy	61.5	76.6	15.1
Latvia	n.a.	8.9	8.9
Lithuania	n.a.	n.a.	n.a.
Luxembourg	57.4	57.8	0.4
Malta	48.1	35.3	-12.7
Netherlands	54.3	60.5	6.2
Poland	38.8	61.1	22.3
Portugal	55.6	71.9	16.3
Romania	76.3	86.7	10.3
Slovenia	84.2	75.8	-8.4
Slovakia			
Spain	72.9	72.9	0.0
Sweden	50.0	57.4	7.4
United Kingdom	43.0	37.7	-5.3
EU-27	**57.1**	**62.6**	**5.5**

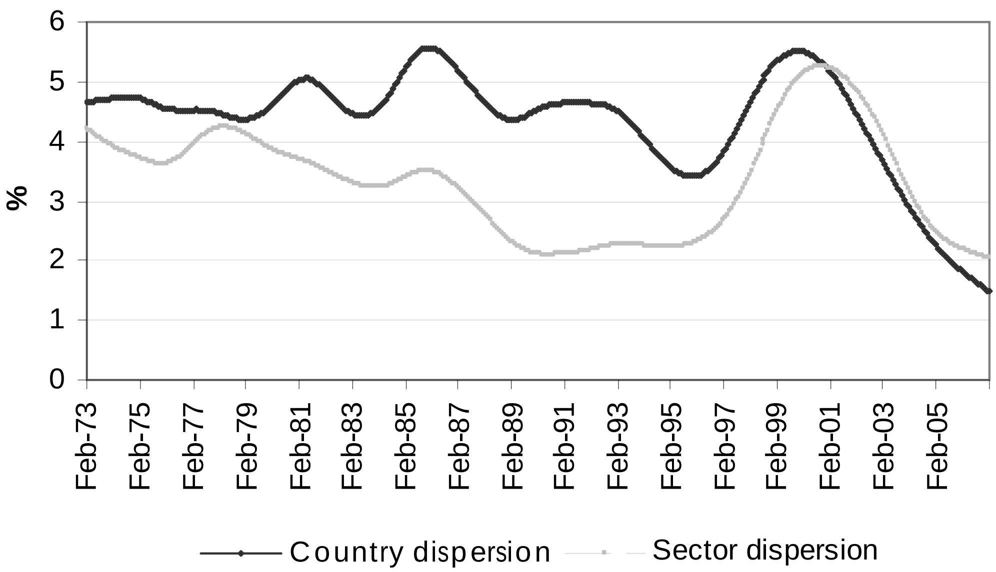
Source: London Economics analysis based on results of Coordinated Portfolio Investment Survey published by the IMF

4.2.3 Equity market

The country dispersion of equity market returns within the EU have fallen steadily since about 2000, when this indicator reached a temporary peak of more than 5%. The narrowing of the dispersion reflects the fact that the various stock markets in the EU have shown a growing tendency to move in tandem, and this trend continued into 2006 and January 2007, the last available data point (see Figure 24).

The sector dispersion of equity market returns within the EU has to a large extent mirrored the decline in country dispersion, although the reduction is slightly less pronounced in late 2006 and early 2007.

Figure 24: Country and sector dispersion of equity market returns in the EU

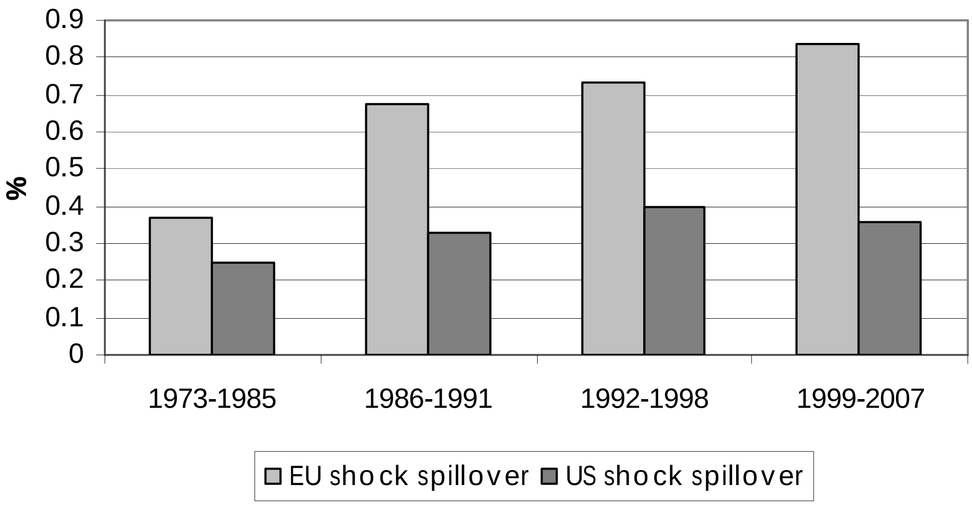


Source: European Central Bank, Indicators of financial integration databank

Moreover, an assessment by the European Central Bank of the contribution of economic shocks emanating from the euro zone (that, is developments unanticipated by financial markets), now explains a much larger proportion of the variation in the returns on local equity markets than in the seventies and eighties. In fact, the European Central Bank estimated that shocks from the eurozone explained more than 80% of the variation of equity market returns over the period 1999-2007, more than twice as much as over the period 1973-1985.

Both the much reduced country dispersion in equity market returns and the sharp rise in the impact of eurozone shocks on the equity markets indicate that domestic stock markets are highly integrated. This is in the sense that they now move closely in tandem irrespective of their location and respond much more to EU-wide unanticipated developments than to local surprises.

Figure 25: Proportion of change in local equity returns explained by eurozone and US shocks



Source: European Central Bank, *Indicators of financial integration* databank

4.2.4 Cross border mergers and acquisition activity in the financial sector

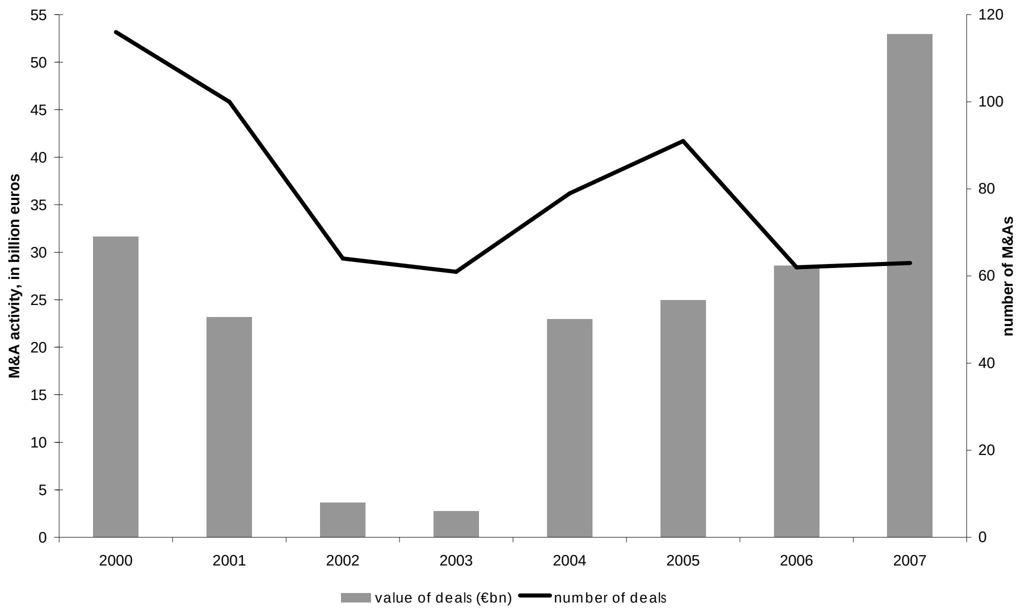
Another indicator of the degree of integration of financial markets is the extent to which financial institutions engage in cross-border merger and acquisition activity (M&A) rather than purely domestic M&A.

The following sections first present some information on the number and value of cross-border M&A deals in the financial sector (including the insurance and pension sectors)[13]. Unfortunately, it is not possible to separate cross-border M&A activity in the wholesale finance sector from M&A activity in the retail finance sector. Nevertheless, such data provide a good picture of the general trend. Next, information is presented on the share of assets held in each domestic EU market by foreign credit institutions from the other EU Member States and outside the EU.

EU cross–border M&A

The value of EU27 cross-border M&A deals originating from within the EU27 jumped by 85% in 2007, reaching a record high of €53 billion in 2007 and largely surpassed the previous record level of €32 billion of 2000 (see Figure 26). This very strong growth in M&A deal value in 2007 follows three years of solid M&A activity of an annual value in the range of €20 to €30 million.

Figure 26: EU cross-border merger activity in EU financial sector, value of deals and number of deals 2000 to 2007



Source: London Economics analysis of M&A data from Zephyr published by Bureau Van Dijk

Assets held by foreign credit institutions

---

13 Because insurance and pensions are included in the financial sectors here, the data reported in Figure 26 differ somewhat from those reported occasionally by the European Central Bank, which focuses exclusively on M&A activity in the banking sector.

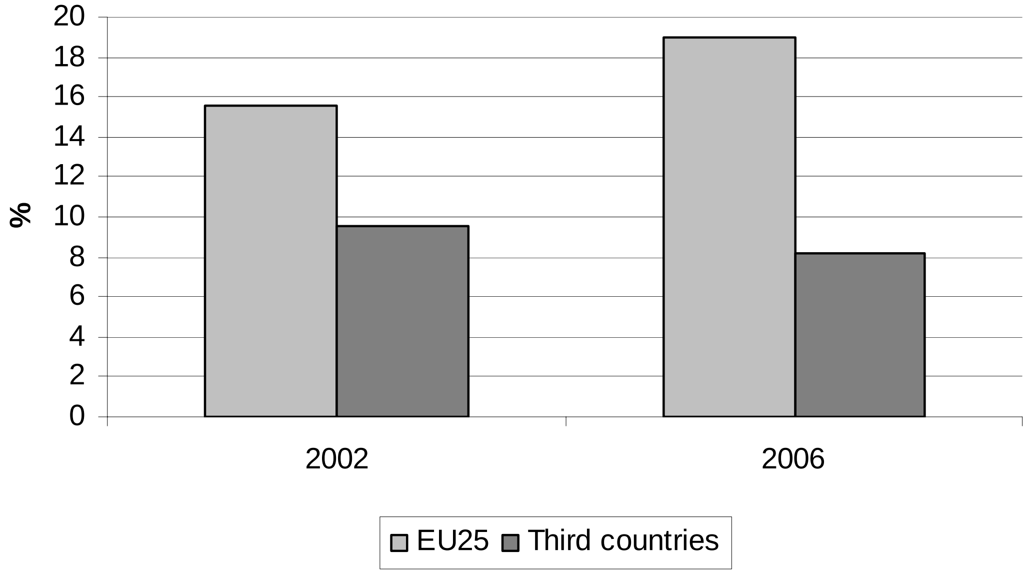
At the level of the EU27, the share of assets held in the various domestic markets by branches and subsidiaries of foreign credit institutions from the EU increased from about 16% in 2002 to about 19% by 2006, the latest year for which such information is available from the European Central Bank (see Figure 27). In contrast, the share of foreign assets held by branches and subsidiaries of credit institutions from outside the EU27 fell slightly over the same period.

That being said, developments across the EU Member States were highly varied (see Table 14):

- Some Member States, such as Finland, Greece, Latvia and Lithuania experienced very large increases, often reflecting the acquisition of a major domestic bank by a foreign, EU-based credit institution;
- Some Members showed small decreases in the share of assets held by branches and subsidiaries of foreign, EU-based credit institutions;
- The other Member States posted increases which were similar to the EU-wide increase or somewhat larger;
- With the exception of Latvia, EU Member States showed very little change, if any change at all, in the share of assets held by branches and subsidiaries of foreign credit institutions from outside the EU.

Overall, the data reported in Table 14 suggest that cross-border financial sector activity has increased slightly in recent years, not only in the New Member States but also in many of the EU15 Member States; this increase is mostly accounted for by branches and subsidiaries of credit institutions from other EU Member States.

Figure 27: Share of assets of branches and subsidiaries of foreign credit institutions - from EU25 and third countries – in total assets of credit institutions



Source: European Central Bank, EU Banking Structures, October 2007

Table 14: Share of assets of branches and subsidiaries of foreign credit institutions - from EU25 and third countries – in total assets of credit institutions

	Share in 2002		Share in 2006		Change in share	
	EU	Third countries	EU	Third countries	EU	Third countries
Austria	20.8	0.6	19.0	0.5	-1.8	-0.1
Belgium	21.8	2.2	21.8	3.1	0.0	0.8
Cyprus	13.8	6.4	25.9	4.4	12.1	-2.0
Czech Republic	87.6	5.5	91.3	5.6	3.7	0.1
Denmark	22.0	0.0	18.4	1.7	-3.6	1.7
Estonia	90.0	0.0	98.5	0.0	8.5	0.0
France	10.9	1.6	9.7	1.2	-1.2	-0.4
Finland	9.1	0.0	56.5	0.0	47.4	0.0
Germany	4.7	1.3	9.3	1.8	4.6	0.5
Greece	5.7	3.9	37.2	0.1	31.5	-3.7
Hungary	56.5	0.0	53.3	3.0	-3.2	3.0
Ireland						
Italy	5.0	0.5	13.5	0.4	8.5	-0.1
Latvia	21.6	17.0	60.1	4.7	38.5	-12.3
Lithuania	55.7	0.0	76.7	0.0	21.0	0.0
Luxembourg	88.6	5.4	86.6	8.0	-2.0	2.6
Malta	35.6	0.0	37.3	0.0	1.7	0.0
Netherlands	8.9	1.3	13.3	1.5	4.4	0.1
Poland	54.8	8.5	57.6	7.8	2.8	-0.7
Portugal	27.1	1.1	21.5	0.8	-5.6	-0.3
Slovenia	16.0	0.0	28.9	0.0	12.9	0.0
Slovakia	82.9	0.0	92.3	0.0	9.4	0.0
Spain	8.5	1.4	10.9	0.5	2.4	-0.9
Sweden	5.9	0.2	8.7	0.2	2.9	0.0
United Kingdom	23.0	24.4	24.8	25.5	1.8	1.2
EU27	**15.8**	**9.8**	**18.5**	**8.1**	**2.7**	**1.7**

Source: European Central Bank, EU Banking Structures, October 2007

5 The European Union's Wholesale Financial Markets

In this chapter we describe recent developments in:

- The banking sector;
- Stock exchanges;
- IPOs;
- The private equity sector;
- The international bond market;
- The foreign exchange market;
- The derivatives market;
- The asset management sector;
- The hedge fund sector; and,
- The insurance sector.

5.1 The banking sector

Until the sub-prime mortgage crisis fully impacted on the financial sector in the autumn of 2007, the year 2007 was shaping up to be another record year.

Worldwide assets of the largest 1000 banks increased by 16% from 2006 to 2007, reaching €54.2 trillion and Tier 1 capital also increased by a sizeable 18.4% to €2.4 trillion in 2007.

European banks competed internationally in terms of scale, as illustrated by Table 15.

Table 15: Top Ten banks by Tier 1 capital in 2007 (€ million)			
Position	**Bank**	**Country**	**Tier 1 capital**
1	Bank of America Corp	US	66,471
2	Citigroup	US	44,452
3	HSBC Holdings	UK	64,118
4	Credit Agricole Group	France	61,998
5	JP Morgan Chase & Co	US	59,164
6	Mitsubishi UFJ Financial Group	Japan	49,974
7	ICBC	China	43,187
8	Royal Bank of Scotland	UK	43,046
9	Bank of China	China	38,334
10	Santander Central Hispano	Spain	34,164

Source: The Banker – Top 1000 World Banks 2007

An important change relative to the figures for 2006, is the improvement in the position of the largest Chinese banks as they replaced their Japanese rivals among the top ten banks in the world.

The presence of four banks from three different EU Member States in the top ten list above suggests a thriving European banking market. Table 16 provides further details on the EU's largest banks by Tier 1 capital and country of incorporation.

Table 16: The EU's largest banks by Tier 1 capital and country of incorporation, share of 300 largest banks in Europe, 2002-2006

	Share of the top 300, 2002	Share of the top 300, 2003	Share of the top 300, 2004	Share of the top 300, 2005	Share of the top 300, 2006
UK	19.6%	18.6%	18.0%	18.9%	19.3%
Germany	17.6%	16.3%	16.3%	15.4%	12.8%
France	14.0%	14.8%	14.8%	13.2%	13.0%
Benelux	11.3%	11.6%	11.6%	11.6%	10.8%
Spain	8.1%	8.6%	8.6%	9.8%	10.2%
Italy	8.4%	8.5%	8.5%	9.0%	8.1%
Scandinavia[+]	5.9%	5.8%	5.8%	6.0%	6.3%
Austria	1.4%	1.5%	1.5%	1.6%	1.9%
Central Europe	…	…	…	0.6%	0.6%

[+]Includes Norway

Source: The Banker – Top 300 European Banks 2005, 2007

The UK's leading position in the EU banking landscape in the past 5 years is evident in the table above. During the same time, Germany's share of the top 300 banks has been steadily decreasing, while Spain's share has been increasing[14]. Finally, one may wish to note the relative gain of Austrian banks as well as the emergence of Central European Banks on the global scale.

The level of bank assets held in countries other than the home country has grown considerably in recent years in practically all Member States, reflecting the growing globalisation of banks (see Table 17).

[14] Some of Spain's progression can be explained by the acquisition of Abbey National in the UK by Banco Central Hispano Santander in 2005.

Table 17: Bank assets held in countries other than the home country, € billion

Country	2001*	2007	Growth 2001-2007
Austria	111	330	197%
Belgium	345	739	114%
Denmark	70	152	117%
Finland	38	67	77%
France	759	1,942	156%
Germany	1,181	2,496	111%
Greece	200	716	258%
Italy	206	456	121%
Luxembourg	565	751	33%
Netherlands	384	962	150%
Portugal	57	95	67%
Spain	167	397	138%
Sweden	71	234	230%
UK	2,453	4,794	95%
Total	**6,607**	**15,140**	**114%**

*Figures expressed at 2006 prices.

Source: Bank of International Settlement Quarterly Review, March 2008

5.2 Stock exchanges

The year 2007 saw momentous changes in the stock market sector. The merger between the NYSE and Euronext was finalised, the LSE bought Borsa Italiana, and Nasdaq became a major shareholder in OMX Nordic Exchange.

All bourses in Europe but three (the Bratislava Stock Exchange, the Luxembourg Stock Exchange and the Malta Stock Exchange) experienced strong growth in turnover (see Table 18).

Table 18: Stock exchanges in Europe

Stock exchange	Capitalisation			Trading in value		
	Level in € billion	Growth from 2006 to 2007	Share of total EU	Level in € billion	Growth from 2006 to 2007	Share of total EU
Athens Exchange	181.2	19.1	1.5	122.4	43.9	0.6
Borsa Italiana	733.6	-5.8	6.2	1680.2	33.6	7.6
Bratislava Stock Exchange	4.6	8.1	0.0	0.0	-69.3	0.0
Bucharest Stock Exchange	21.5	14.1	0.2	2.0	56.8	0.0
Budapest Stock Exchange	31.5	-0.5	0.3	34.6	40.5	0.2
Bulgarian Stock Exchange	14.8	89.3	0.1	4.6	227.5	0.0
Cyprus Stock Exchange	20.2	64.5	0.2	4.2	25.4	0.0
Deutsche Börse	1440.0	15.9	12.3	3144.2	45.2	14.2
Euronext	2888.3	2.7	24.6	4086.8	34.1	18.4
Irish Stock Exchange	98.4	-20.5	0.8	99.6	54.1	0.4
Ljubljana Stock Exchange	19.7	71.1	0.2	3.1	113.0	0.0
London Stock Exchange	2634.6	-8.4	22.4	7545.0	25.9	34.0
Luxembourg Stock Exchange	113.6	88.4	1.0	0.2	-6.1	0.0
Malta Stock Exchange	3.9	12.8	0.0	0.1	-68.5	0.0
OMX Nordic Exchange	849.9	-0.2	7.2	1321.8	27.5	6.0
Oslo Børs	241.7	13.9	2.1	399.1	24.3	1.8
Prague Stock Exchange	48.0	38.3	0.4	36.6	21.9	0.2
Spanish Exchanges (BME)	1231.1	22.7	10.5	2160.3	40.7	9.7
SWX Swiss Exchange	869.4	-5.4	7.4	1368.8	24.1	6.2
Warsaw Stock Exchange	144.3	27.9	1.2	63.9	47.7	0.3
Wiener Börse	161.7	7.1	1.4	94.5	45.6	0.4

Source: London Economics analysis based on data from the Federation of European Securities Exchanges (FESE)

Capitalisation also increased significantly at most bourses, the exceptions being Borsa Italiana, the Budapest Stock Exchange, the Irish Stock Exchange, the London Stock Exchange, OMX Nordic Exchange, and the SWX Exchange.

Despite the drop in capitalisation at some of the larger stock exchanges, in 2007 the top 7 stock exchanges (Euronext, London Stock Exchange, Deutsche Börse, Spanish Exchanges (BME), SWX Europe, OMX Nordic Exchange and Borsa Italiana) overall accounted for more than 90% of the total capitalisation on European stock exchanges.

In terms of turnover, these same bourses accounted for 96% of total trading in value among the stock exchanges listed in table 18.

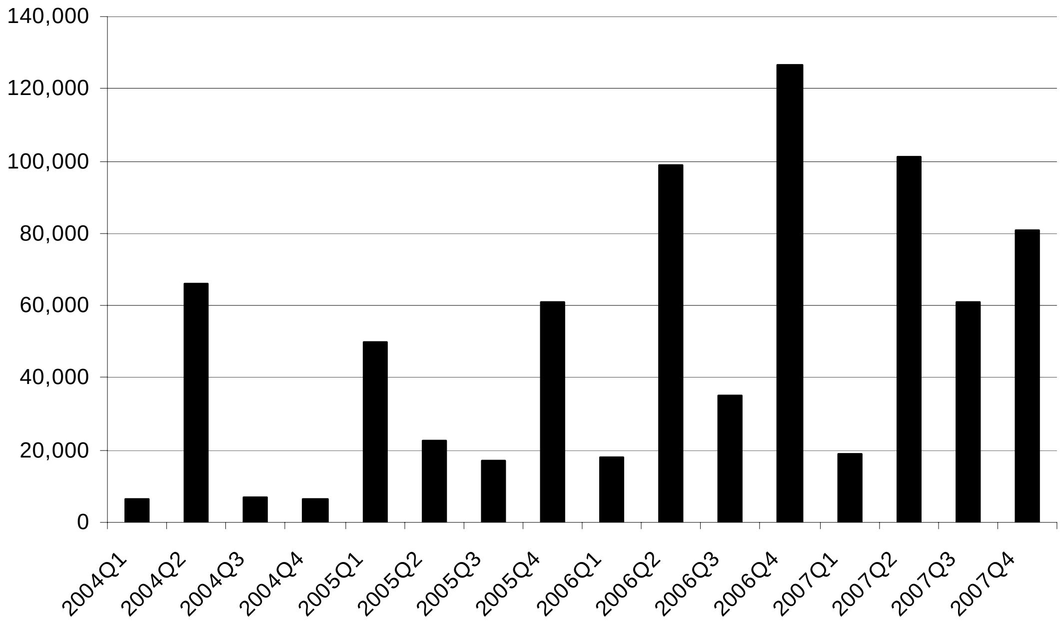
While the large stock exchanges from the EU15 continue to dominate the sector, it should be noted that it is the bourses from a number of the New Member States which posted the best performance in terms of growth in capitalisation and turnover in 2007.

5.3 IPOs

The IPO segment also increased substantially in the past couple of years, with funds raised through newly listed companies growing from €85.4 billion in 2004 to €261.8 billion in 2007, an increase of more than 200%.

It should be noted that the value of funds raised through IPOs on European stock exchanges in 2007 showed considerable variation through the year, mirroring to some extent the within-year variation observed in previous years (see Figure 28).

Figure 28: Funds raised through IPOs in 2004-2007, € billion



Source: Federation of European Security Exchanges, London Stock Exchange and Deutsche Börse

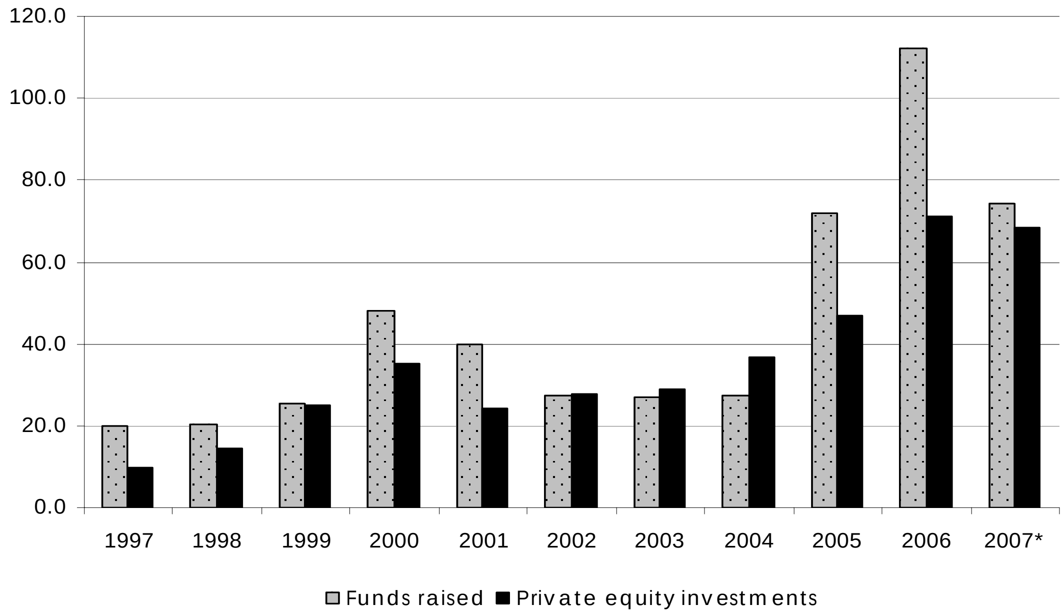
At the individual exchange level, the Deutsche Börse was by far the major market for IPOs, accounting for 72% of funds raised through IPOs in 2007, followed by the London Stock Exchange (11%) and Euronext (4%), with the remaining exchanges accounting for the other 3%.

5.4 The private equity sector

Compared to previous years, the private equity sector continued to be very active in 2006. In particular, funds raised by private equity and venture capital management companies, and private equity investments, reached an all time high in 2006, €112.3 billion and €71.6 billion respectively[15]. Due to the difficult market conditions in the second half of the year, however, funds raised fell to back €74.3 billion in 2007, while private equity investments also slightly dropped to €68.3 million.

Figure 29 puts the latest developments in perspective. It shows that after a 3-year hiatus following the end of the dotcom boom, the level of funds raised and invested vastly surpassed the levels experienced during the dotcom boom.

Figure 29: Funds raised and annual private equity investments in Europe, 1997-2007 € billion



*Estimated figure

Source: European Private Equity and Venture Capital Association (EVCA), Annual Survey 2006

[15] Clearly, favourable credit conditions and weak yields on alternative investments contributed to this trend.

In 2006, the UK kept its top position, accounting for more than a third of total investments. France and Germany were the next biggest players; together with the UK, the three countries accounted for almost 64% of total European private equity and venture capital investment in 2006.

Table 19: Private equity and venture capital investments in EU countries, 2006 (€ billion)

Country	Investments	Share of total investments	Investments as % of GDP
Austria	266.8	0.4%	0.10%
Belgium	1,404.4	2.1%	0.45%
Czech Republic	516.5	0.8%	0.45%
Denmark	740.8	1.1%	0.34%
Finland	391.0	0.6%	0.23%
France	10,936.7	16.5%	0.61%
Germany	7,301.3	11.0%	0.31%
Greece	81.5	0.1%	0.03%
Hungary	538.3	0.8%	0.60%
Ireland	691.4	1.0%	0.39%
Italy	4,935.3	7.4%	0.33%
Netherlands	5,625.1	8.5%	1.05%
Poland	559.2	0.8%	0.21%
Portugal	179.2	0.3%	0.12%
Romania	109.2	0.2%	0.11%
Spain	3,616.4	5.4%	0.37%
Sweden	4,418.9	6.6%	1.44%
United Kingdom	24,143.0	36.3%	1.26%
Total*	**66455.1**	**100.0%**	

*Refers to the sum of the countries in the table, as no data was available for Member States with low level of investments.

Source: European Private Equity and Venture Capital Association (EVCA), Annual Survey 2006

The next group of countries of significant private equity and venture capital investment comprises the Netherlands, Italy and Spain. Together these 3 countries accounted for another 21% of total European private equity and venture capital investment in 2006.

Such investment can be very substantial in relation to overall GDP. In fact, private equity and venture capital investments exceeded 1% of the GDP in three European countries in 2006, namely the UK, Sweden and the Netherlands.

5.5 The international bond market

With €8.1 trillion in outstanding international debt securities, the EU27 accounted for 58.4% of world-wide outstanding international debt securities (see Table 20).

Within the EU27, Germany, the UK, France, Spain, Italy and the Netherlands accounted for 81% of total outstanding international debt securities and the largest source country was Germany. The latter accounted for 18% of EU27 outstanding international debt securities.

Of interest is the fact that these six Member States accounted for only 70% of the 2007 increase in outstanding international debt securities. Moreover, within this group of six Member States, Germany's share of the increase was considerably lower than its share of the stock of outstanding international debt securities, although Spain's share was considerably higher.

Outside this group of six Member States, Belgium's and Ireland's share of the increase was considerably larger than their share of the stock of outstanding international securities; no notable differences were observed in the case of the other Member States.

Table 20: International debt securities outstanding, by nationality of issuer

Country	Amount outstanding, end of year, € billions			Share of EU27 total - 2007	Share of increase in EU total 2006 to 2007	Share of world total - 2007
	2000	2006	2007			
Austria	86.3	207.5	236.7	2.6	3.1	1.5
Belgium	139.7	280.7	347.0	3.8	6.9	2.2
Bulgaria	5.5	2.3	2.0	0.0	0.0	0.0
Cyprus	1.4	3.7	4.8	0.1	0.1	0.0
Czech Republic	2.0	5.6	6.9	0.1	0.1	0.0
Denmark	26.5	65.5	85.2	0.9	2.1	0.5
Estonia	0.3	1.4	1.2	0.0	0.0	0.0
Finland	41.2	79.5	75.9	0.8	-0.4	0.5
France	341.9	950.1	1,050.8	11.5	10.6	6.7
Germany	908.8	1,962.8	2,038.0	22.4	7.9	13.1
Greece	29.6	149.8	178.2	2.0	3.0	1.1
Hungary	11.0	21.0	23.4	0.3	0.3	0.2
Ireland	36.3	212.6	302.5	3.3	9.4	1.9
Italy	271.8	705.4	794.6	8.7	9.3	5.1
Latvia	0.2	0.9	0.9	0.0	0.0	0.0
Lithuania	1.1	3.2	4.0	0.0	0.1	0.0
Luxembourg	13.2	73.3	72.5	0.8	-0.1	0.5
Malta	0.4	0.2	0.2	0.0	0.0	0.0
Netherlands	313.4	711.1	767.0	8.4	5.9	4.9
Poland	10.1	30.6	30.1	0.3	0.0	0.2
Portugal	36.6	130.3	150.9	1.7	2.2	1.0
Romania	1.2	3.4	2.9	0.0	-0.1	0.0
Slovakia	3.0	3.1	3.9	0.0	0.1	0.0
Slovenia	1.9	1.5	2.8	0.0	0.1	0.0
Spain	216.3	824.2	1029.1	11.3	21.5	6.6
Sweden	106.9	157.5	186.3	2.0	3.0	1.2
United Kingdom	577.7	1,560.7	1,704.4	18.7	15.1	10.9
Total EU27	**3,184.5**	**8,147.9**	**9,102.0**	**100.0**	**3.1**	**58.4**

Source: Bank for International Settlements

5.6 The foreign exchange market

In April 2007, world-wide foreign exchange market daily turnover reached €2.9 trillion. The US accounted for 16.7% and the UK for 34.7% of world-wide daily turnover while the EU27's share of daily turnover world-wide stood at 48.9%[16].

Reflecting the strong concentration of foreign exchange trading in the UK, 70% of the total EU27 market turnover in foreign exchange in 2007 and 76% of the increase in EU27 foreign exchange market turnover between 2004 and 2007 were accounted for by the UK (see Table 21).

France and Germany were the only other EU27 Member States which accounted for more than 5% of total EU27 foreign exchange market turnover in 2007.

[16] See Bank for International Settlements, Triennial Central Bank Survey Foreign Exchange and derivatives market activity in 2007, December 2007

Table 21: Foreign exchange daily market turnover					
Country	Average daily turnover in April, € billion			Share of EU27 turnover	Share in increase in EU27 turnover
	2001	2004	2007	2007	2004 to 2007
Austria	8.9	10.5	13.1	0.9	0.6
Belgium	11.2	16.1	35.0	2.5	3.5
Bulgaria			0.7	0.1	
Cyprus					
Czech Republic	2.2	1.6	3.6	0.3	0.4
Denmark	25.7	33.0	62.7	4.4	5.7
Estonia		0.0	0.7	0.1	0.1
Finland	2.2	1.6	5.8	0.4	0.8
France	53.6	51.5	87.5	6.2	7.0
Germany	98.3	94.9	72.2	5.1	-2.4
Greece	5.6	3.2	3.6	0.3	0.1
Hungary	1.1	2.4	5.1	0.4	0.5
Ireland	8.9	5.6	8.0	0.6	0.5
Italy	19.0	16.1	26.3	1.8	2.0
Latvia		1.6	2.2	0.2	0.1
Lithuania		0.8	0.7	0.1	0.0
Luxembourg	14.5	11.3	31.4	2.2	3.6
Malta					
Netherlands	33.5	39.4	17.5	1.2	-3.1
Poland	5.6	4.8	6.6	0.5	0.4
Portugal	2.2	1.6	2.2	0.2	0.1
Romania			2.2	0.2	
Slovakia	1.1	1.6	2.2	0.2	0.1
Slovenia	0.0	0.0	0.0	0.0	0.0
Spain	8.9	11.3	11.7	0.8	0.3
Sweden	26.8	24.9	30.6	2.2	1.4
United Kingdom	563.0	605.4	991.2	69.7	76.1
Total EU27	**883.6**	**928.6**	**1422.9**		

Source: London Economics calculations based on Bank for International Settlements, Triennial Central Bank Survey Foreign Exchange and derivatives market activity in 2007, December 2007

5.7 The derivatives market

Derivatives fall into two categories: (i) over-the-counter (OTC) derivatives which refer to derivatives traded directly between two parties, and (ii) exchange derivatives which are traded through a financial intermediary.

With 83% of derivatives having been contracted over-the-counter at the end of 2006, OTC derivatives make up a larger part of the derivatives market[17].

The most notable development in the world-wide OTC derivatives sector is that the combined share of interest rate and foreign exchange derivatives in total OTC trade fell from 89.2% in 2004 to 74.8% in 2007. This was as other derivatives, including equity-linked and commodity contracts, and especially credit default swaps, thrived[18]. In particular, credit default swaps, almost non-existent in 2004, made up more than 8.2% of total OTC derivatives sales in 2007[19].

The EU27 continued to dominate the world OTC derivative market, accounting for 65.9% of the interest rate derivative market and 60.4% of the foreign exchange derivative market in 2007. Within the EU, London is the major OTC derivative trading centre, accounting for 38.6% and 44.0% of global trade in foreign exchange and interest rate derivatives markets, respectively.

Daily average turnover in the EU's interest rate and foreign exchange derivatives markets has grown substantially between 2004 and 2007.

---

[17] See BIS, OTC derivatives market activity in the second half of 2006.

[18] The figures in this section are based, unless noted otherwise, on the: Bank of International Settlements, *Triennial Central Bank Survey, Foreign exchange and derivatives market activity in 2007*

[19] Credit default swaps grew at an annual rate in excess of 90% between 2005 and 2007.

Table 22: Over-the-counter foreign exchange and interest rate derivatives daily average turnover (2007)

	Daily average turnover in FX derivatives 2007, € million	Share of EU FX derivatives, 2007	Share of growth in EU FX derivatives between 2004 and 2007	Daily average turnover in interest rate derivatives 2007, € million	Share of EU interest rate derivatives, 2007	Share of growth in EU int. rate derivatives between 2004 and 2007
Austria	9.5	0.8%	0.5%	3.6	0.4%	-2.9%
Belgium	25.5	2.2%	3.3%	16.1	1.6%	-3.4%
Czech	2.9	0.2%	0.5%	0.7	0.1%	0.0%
Denmark	53.3	4.5%	6.2%	7.3	0.7%	-0.6%
Finland	5.8	0.5%	1.2%	2.2	0.2%	0.8%
France	74.5	6.3%	7.1%	128.5	12.9%	2.5%
Germany	56.2	4.8%	-2.8%	65.7	6.6%	11.8%
Greece	2.9	0.2%	0.1%	0.0	0.0%	0.0%
Hungary	3.6	0.3%	0.5%	0.7	0.1%	0.3%
Ireland	5.1	0.4%	0.6%	5.1	0.5%	-1.7%
Italy	19.0	1.6%	1.6%	21.9	2.2%	-3.3%
Latvia	1.5	0.1%	0.2%	0.0	0.0%	0.0%
Luxembourg	22.6	1.9%	3.2%	2.2	0.2%	-1.3%
Netherlands	16.1	1.4%	-4.1%	19.7	2.0%	1.7%
Poland	5.1	0.4%	0.2%	2.2	0.2%	0.8%
Portugal	2.2	0.2%	0.3%	0.7	0.1%	0.0%
Romania	1.5	0.1%	0.3%	0.0	0.0%	0.0%
Slovakia	2.2	0.2%	0.3%	0.0	0.0%	0.0%
Spain	8.0	0.7%	0.0%	12.4	1.2%	1.0%
Sweden	26.3	2.2%	1.4%	8.8	0.9%	1.2%
UK	838.0	70.9%	79.3%	698.5	70.1%	92.9%
Total	**1182.5**	**100.0%**	**100.0%**	**996.4**	**100.0%**	**100.0%**

Source: Bank of International Settlements, Triennial Central Bank Survey, Foreign exchange and derivatives market activity in 2007

In particular, daily average turnover in the EU's derivatives markets rose to €996.4 million in 2007 from €733.1 million in 2004 for interest rate derivatives markets, and to €1182.5 million in 2007 from €747.4 million in 2004 for foreign exchange derivatives.

The UK took the lion's share of this increase, accounting for 92.9% of the growth in interest rate derivatives trade and for 79.3% of the growth in foreign exchange derivatives trade.

In 2007, the UK traded 70% of EU interest rate derivatives and 71% of EU foreign exchange derivatives (see Table 22).

The exchange traded derivatives also experienced a significant increase over the past couple of years, with the notional value of total contracts growing by 33% between 2004 and 2006, from €363.6 trillion to €484.9 trillion. More than 98% of exchange derivatives trade took place on Euronext Liffe (76.2%) and Eurex (22.1%) in 2006.

Among the various exchange derivatives, short-term interest rate futures kept their large share of more than 55% of total trade throughout the years, while derivatives related to stock indices (options and futures) increased their share from 4.3% to 6.8%.[20]

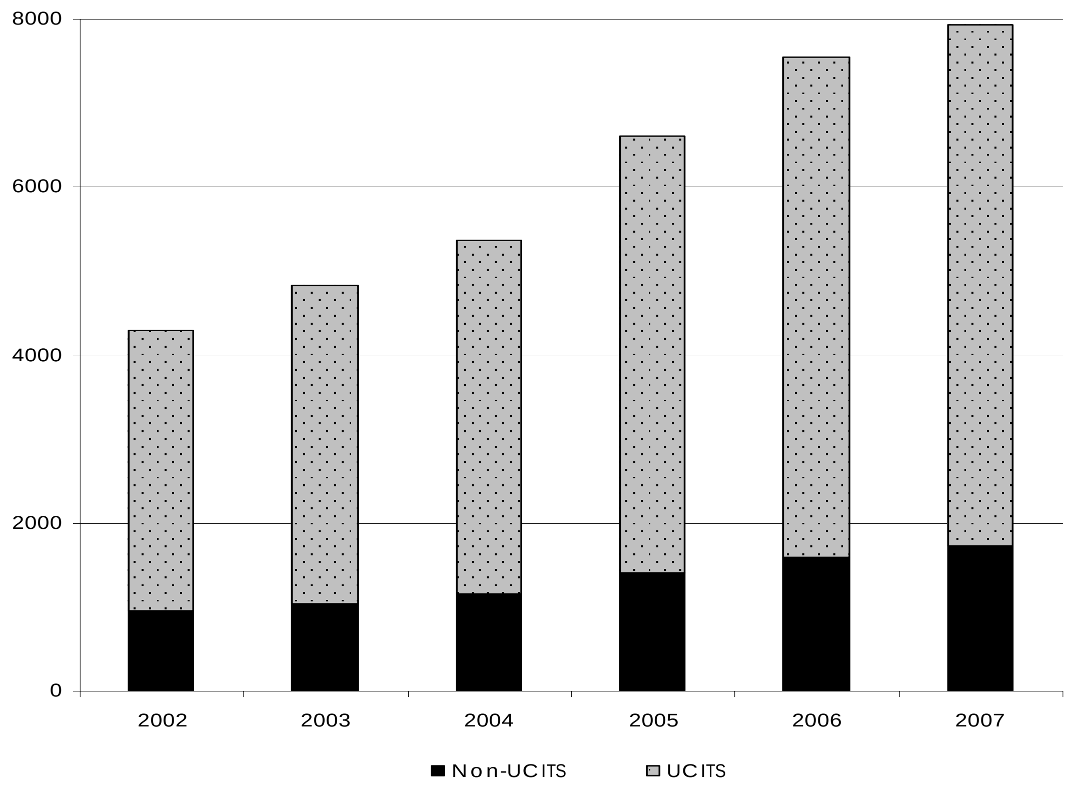
5.8 The asset management sector

The European asset management sector continued to grow in 2007, with the value of net assets of investment funds surpassing the 2006 figure by almost €440 billion and reaching €7.925 trillion by the end of the year, an increase of almost 5%.

In particular, total net assets of Undertakings for Collective Investments in Transferable Securities (UCITS) grew by 4.2% to €6.203 trillion, whereas non-UCITS assets grew by 5.3% to €1.723 trillion. The following figure documents the growth in the value of net assets of European investment funds during the 5-year period from 2002 to 2007.

[20] See Word Federation of Exchanges, Annual Statistics 2004-2006 for further information on exchange traded derivatives.

Figure 30: Net Assets of European Investment Funds, € billion



Source: European Fund and Asset Management Association, Quarterly Statistical Release, March 2008

When looking at the stock of assets by country of domiciliation, the pattern of change from 2006 to 2007 is mixed.

In particular, EU-wide growth in assets is largely, but not entirely, driven by growth in the UK, Luxembourg and Ireland. These three countries' share in the European total exceeds 10%, and all enjoy healthy growth, especially Luxembourg and Ireland, which both recorded double-digit growth.

Also of note is the strong growth experienced in the Central European countries; this shows the great potential of those countries. Their impact on the EU27 figures remains modest at the present time, however, because in absolute terms these markets are still very small in comparison to some of the markets in the EU15.

Table 23: Geographical breakdown of the net assets of the EU investment fund industry (€ billion)

Country	Investment funds assets, end of 2007	Percentage of European total	Investment funds assets, end of 2006	Percentage change from 2006 to 2007
Austria	165.6	2.2%	168.9	-1.9%
Belgium	126.5	1.6%	127.9	-1.1%
Czech Republic	6.1	0.1%	5.4	12.5%
Denmark	132.2	1.7%	122.6	7.9%
Finland	66.0	0.9%	60.9	8.3%
France	1,508.3	19.7%	1,494.4	0.9%
Germany	1,040.9	13.6%	1,017.7	2.3%
Greece	22.9	0.3%	24.8	-7.7%
Hungary	12.6	0.2%	10.1	24.6%
Ireland	806.8	10.5%	717.7	12.4%
Italy	339.7	4.4%	383.4	-11.4%
Luxembourg	2,059.4	26.8%	1,844.8	11.6%
Netherlands	91.1	1.2%	101.8	-10.5%
Poland	36.9	0.5%	25.8	43.1%
Portugal	36.2	0.5%	38.9	-6.9%
Romania	0.3	0.0%	0.2	28.5%
Slovakia	3.9	0.1%	3.1	28.1%
Slovenia	4.1	0.1%	2.9	46.2%
Spain	278.8	3.6%	287.8	-3.1%
Sweden	139.4	1.8%	140.9	-1.1%
United Kingdom	797.0	10.4%	752.8	5.9%
Total*	**7,674.7**	**100.0%**	**7,332.8**	**4.9%**

*Refers to the sum of the countries in the table, as no data was available for Member States with low level of investment funds assets.

Source: European Fund and Asset Management Association, Quarterly Statistical Release, March 2008

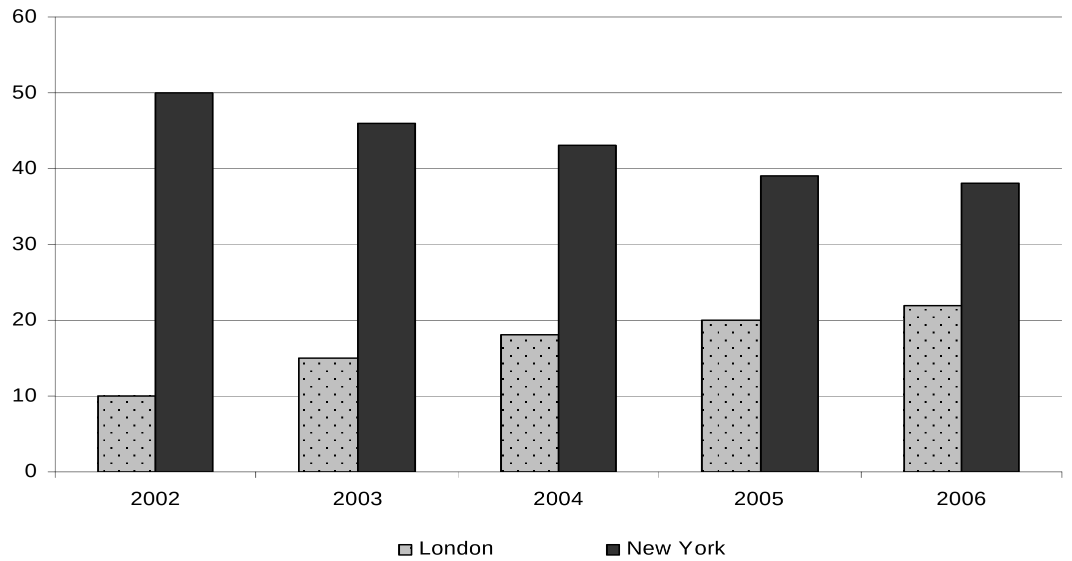
Finally, of note is the fact that, although the figures in Table 23 refer to the investment fund industry, the UCITS market segment shows similar patterns.

5.9 The hedge funds sector

The value of assets under management by hedge funds based, although not necessarily domiciled, in EU27 Member States stood at €366.3 billion in 2007.

The US remains the leading location of hedge fund management, accounting for about two thirds of total assets under management by hedge funds, with New York accounting for 45% of the total alone. London, however, has developed as the second most important world centre for hedge funds (with 21%) and has been taking market share from New York (see Figure 31).

Figure 31: Assets under management by hedge fund industry – percentage share of New York and London



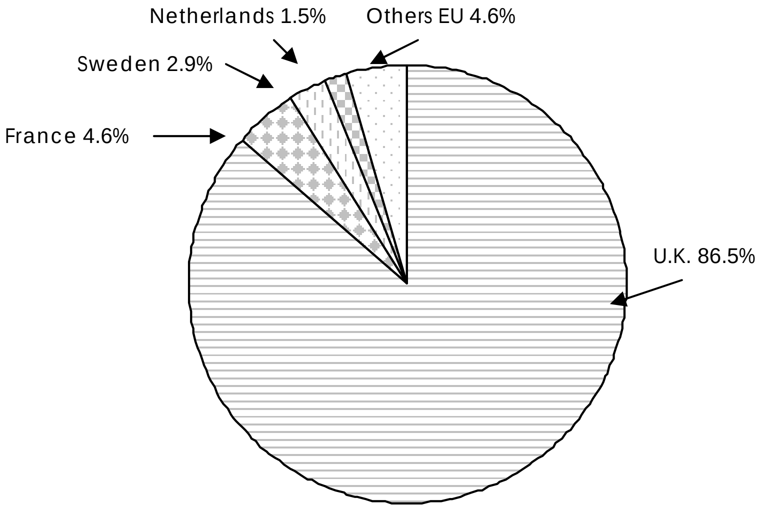
Source: International Financial Services, London (IFSL), International Financial Markets in the UK, November 2007

Within the EU, the sector is heavily concentrated in the UK, essentially London, accounting for 86.5% of total assets under hedge fund management in the EU.

Hedge fund activity has also intensified in France, Sweden and the Netherlands in the past couple of years, with these three countries together accounting for nearly 10% of the total assets under hedge fund management in the EU (see Figure 32).

Finally, it is interesting to note that 80% of hedge funds assets managed from within the EU are actually assets of hedge funds domiciled outside the EU27 and only 15% represent assets of funds domiciled in the EU27[21].

Figure 32: Hedge fund management in EU Member States



Source: The Eurohedge Database, 2008

5.10 The insurance market

The total value of the world insurance premia written remained flat in 2007, at 2006 levels of €2.7 trillion. The share of life and non-life insurance contracts stayed the same, at 59% and 41% respectively.

In terms of geographic breakdown, the US accounted for more than 30% of the world's total insurance premia, followed by Japan and the UK, with shares of 12.4% and 11.2% respectively.

[21] The source for this information is the Eurohedge database. No domicile information is provided for 5% hedge fund assets.

Interestingly, these two countries experienced diverging developments in 2006 as Japan recorded a decrease of 12.2% in insurance premia written, whereas the UK reported an increase of 13.5% (see Table 24).

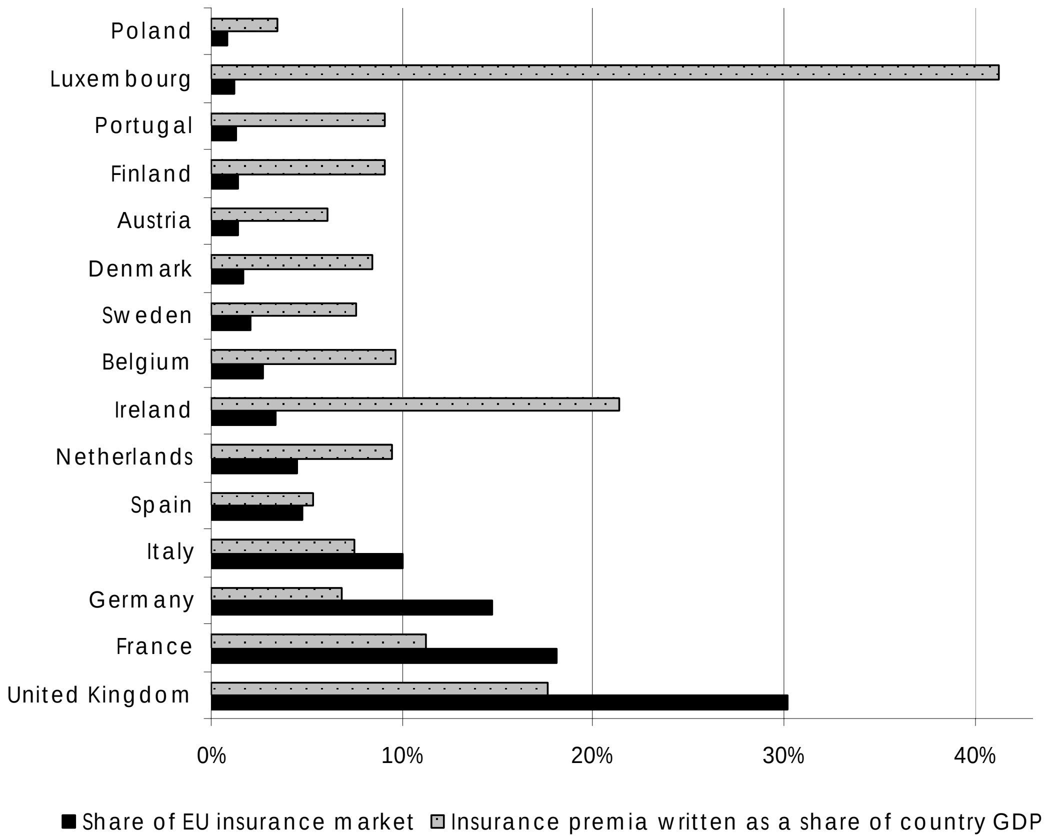
Table 24: Growth in insurance premia

Country	Insurance premium written 2005 (€ billion)	Insurance premium written 2006 (€ billion)	Change in insurance premium written	Percentage relative to world total (%)
World	2,741	2,718	-0.8%	100.0%
US	888	854	-3.8%	31.4%
Japan	382	336	-12.2%	12.4%
UK	269	305	13.5%	11.2%
Europe excluding UK	1,068	1,084	1.5%	39.9%

Source: Swiss Re, Sigma No 4/2007

In Europe, the UK's status as the premier market stands out as it accounted for more than 30% of the EU insurance market. The other major markets, all with a market share larger than 10%, are France, Germany and Italy (see Figure 33).

Figure 33: Insurance premia written relative to total EU premia written and GDP, 2006



Source: Swiss Re, Sigma No 4/2007

6 The Future of European Wholesale Financial Services

6.1 Background

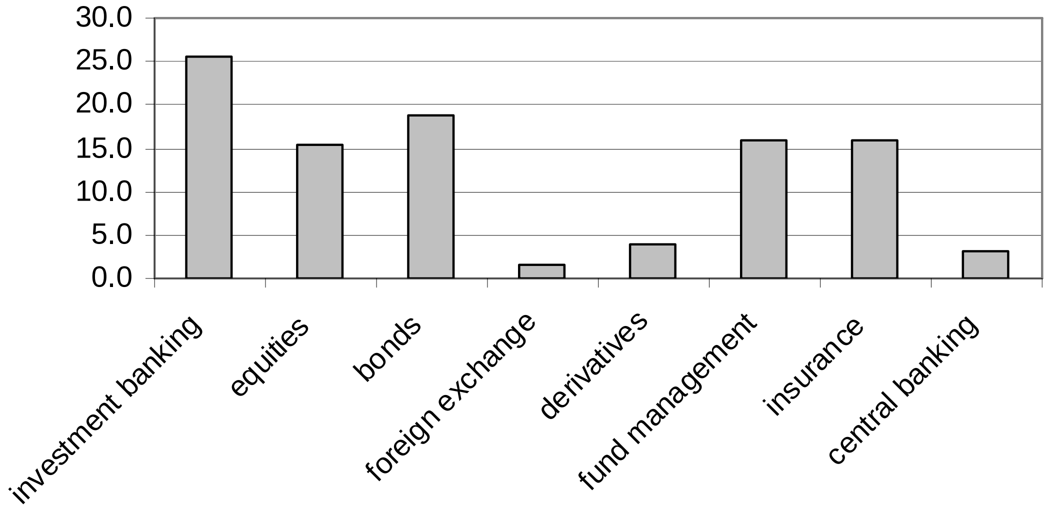
The financial and business press has regularly carried articles in the last six months suggesting that between 50,000 and 100,000 jobs may be lost globally in the wholesale financial services sector as banks and a number of other financial institutions downsize in response to the sub-prime credit crunch.

While such numbers may appear very large, it is important to recall that wholesale financial services in the EU27 are estimated to employ about 1.4 million persons as at end-2007. Moreover, whilst the focus in the press is on the number of jobs that will be lost as a result of the credit crunch, these jobs losses are likely to be concentrated at a limited number of major banks, especially investment banks.

Yet wholesale financial services is comprised of many other sub-sectors, such as equity, debt, derivative and commodity markets, asset management, insurance, hedge funds, and private equity, for example, many of which are reviewed in the previous chapter. Many institutions in these other sub-sectors have been much less impacted on, if at all, by the credit crunch so far. Furthermore, they are likely to continue to grow provided the economic outlook does not deteriorate significantly.

In the key financial centres of Europe, namely Brussels, Frankfurt, Holland, Ile de France, Lombardy, London, Madrid and Stockholm, for example, the previous City of London report on the EU wholesale financial services industry showed that only about 25% of total employment by the wholesale financial services industry was in investment banking (see Figure 34 overleaf)

Figure 34: Percentage share of total EU27 wholesale financial services employment by main sub-sectors



Source: City of London, The Importance of Wholesale Financial Services to the EU Economy 2007, p. 52

6.2 Key drivers

In order to make any prognosis about the future of the EU wholesale financial services industry, it is important to step back from the most recent developments and focus on the key drivers likely to affect the overall environment in which the industry operates.

Many, but not all, of these drivers are exogenous to the sector, in the sense that the industry has little control over them but could be significantly affected by them.

Below we list those drivers which are likely to be the most prominent over the coming years:

1. First and foremost is the overall state of the economy as the level of demand for wholesale financial services is heavily dependent on the state of the economy. This is true not only for the domestic economy but also, more generally, for the world economy, as a significant share of the wholesale financial services produced in the EU27 are exported to the rest of the world.

2. The evolution of domestic savings flows will impact on the amount of new funds that the wholesale (and retail) financial services sector will be intermediating over the coming years.

3. The competitive pressures from established major financial centres such as New York, and emerging major financial centres in the BRICs, especially China and in the Gulf region, will clearly impact on the world market share of financial services that the EU27 wholesale financial services sector will be able to gain in coming years. Globalisation, liberalisation and the rapid development of key emerging economies such as those of Brazil, Russia, India and China (the so-called BRICs), give rise to numerous challenges and opportunities for the EU27 wholesale financial services sector.

4. Changes in the regulatory environment will also have an impact on the future development of the EU27 wholesale financial services industry.

5. Finally, in considering the likely evolution of the EU27 wholesale financial services industry, one needs to take account of likely changes in business models pursued by the various players in the sector.

While many other factors are likely to affect one or the other sub-sector of the EU27 wholesale financial services industry in the coming years, the five key drivers listed above are the fundamental drivers which will have a determinant influence over the medium term.

The following sections first assess the impact of the announced downsizing measures on the EU27 wholesale financial services sector. The key drivers and their likely impact on the EU27 wholesale financial services industry are next discussed in greater detail. Finally, a number of scenarios are developed, which are then used to project the likely path of the EU27 wholesale financial services industry over the next five years.

6.3 Impact of the downsizing

The credit crunch and the resulting job losses have considerably changed the near-term outlook for the sector, relative to what one would have expected only a year ago. In order to assess the direct impact of the job losses on the EU27 wholesale financial services industry, the following assumptions are made:

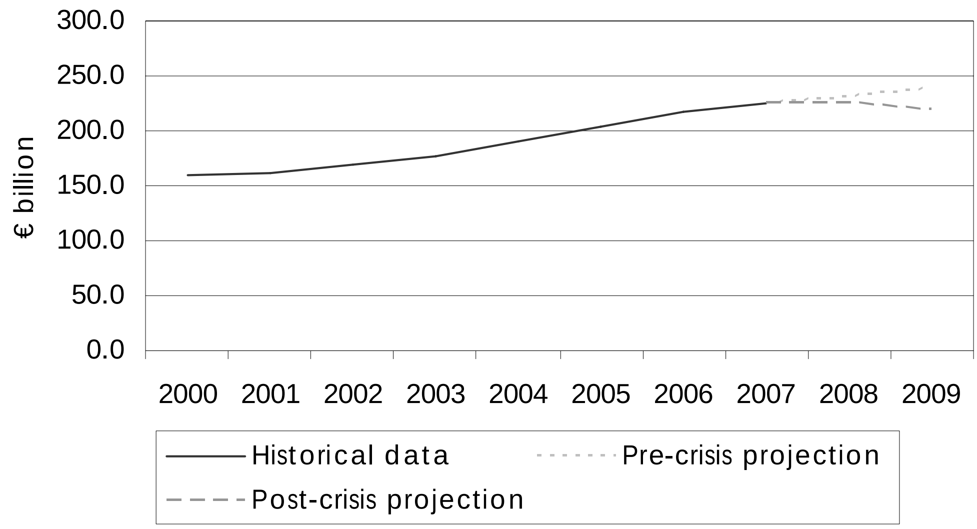
1. Job losses will total 75,000;

2. The level of wholesale financial services GVA per person losing his/her job is 25% higher that the average productivity level in the sector. This reflects the fact that the expected job losses are concentrated in the investment banking sector;

3. Moreover, because the job losses are concentrated in the second half of 2008, the full impact of the downsizing will only be reflected in the annual figures for 2009;

Overall, and abstracting from any other developments, on the basis of the assumptions listed above, the GVA level (at 2007 prices) of the EU wholesale financial services sector will be 8% lower in 2009 than the level that would have prevailed in the absence of the credit crisis (see Figure 35). Obviously, a number of other factors will affect the near-term outlook of the EU27 wholesale financial services sector and these are discussed below in the scenario analysis.

Figure 35: Impact of downsizing in EU27 wholesale financial services sector



Source: London Economics

6.4 The key drivers and their impact

6.4.1 Economic outlook

The forecasts recently released by the European Commission and the IMF show a marked slowdown of about three quarters of one percentage point in economic growth in the two years 2008-2009 relative to the previous 4-year period. This slowdown is expected to be largely cyclical, however, and by the end of the present decade, the EU27 economy is expected to expand at about the same rate as before the current slowdown (see Table 25).

The wholesale financial services industry typically grows significantly faster than economy-wide GVA. But during an economic slowdown, wholesale financial services tends to be hit disproportionately harder compared with economy-wide GVA, due to the former's greater cyclical sensitivity. Given the initial financial nature of this downturn, triggered by the US subprime crisis, this is certainly likely to happen this time.

Table 25: Economic outlook – projected average real GDP growth

	European Commission		IMF		
	2004-2007	**2008-2009**	**2002-2007**	**2008-2009**	**2009-2012**
World	5.3%	4.1%	5.3%	3.8%	4.9%
EU27	2.6%	1.9%	2.6%	1.8%	2.7%

Source: European Commission. Economic Forecasts, Spring 2008, IMF, World Economic Outlook, April 2008

6.4.2 Private Savings

As noted earlier, the level of private savings is one of the determinants of the volume of funds that the wholesale sector, together with the retail sector, intermediates.

The latest forecast from the European Commission shows that, after falling to a recent low of 18.5% in 2006 and 2007, the gross private saving rate is expected to grow slowly in 2008 and 2009. While no forecasts of the gross private savings rate are available post 2009, three of the scenarios assume that the gross private savings rate remains unchanged over the medium term; in one scenario it continues to rebound slowly, reaching 19.5% by 2012 (see Table 26).

Thus, on the basis of the observed historical relationship between the gross private savings rate and EU27 wholesale financial services GVA, one would expect the latter to benefit from a small boost relative to a scenario in which the savings rate does not rebound.

Table 26: EU27 gross private sector and national saving as a percentage of GDP 2004-2009

	2003	2004	2005	2006	2007	2008	2009
Private	19.8	20.1	19.3	18.5	18.5	18.8	18.9
National	19.7	20.2	19.9	20.3	20.8	20.9	20.8

Source: European Commission, Economic Forecasts, Spring 2008

6.4.3 Competitive challenge

One of the striking features of the economic outlook for the next few years is the rapid accumulation of very large current account surpluses by advanced Asian economies (China, Hong Kong, Korea, Singapore and Taiwan) and the oil-producing States in the Gulf and Saudi Arabia. After generating surpluses of US$1.7 trillion over the period 2006-2008, these two groups of countries are expected to generate jointly a further staggering cumulative surplus of US$4.6 trillion from 2009 to 2013 (see Figure 36 and Table 27).

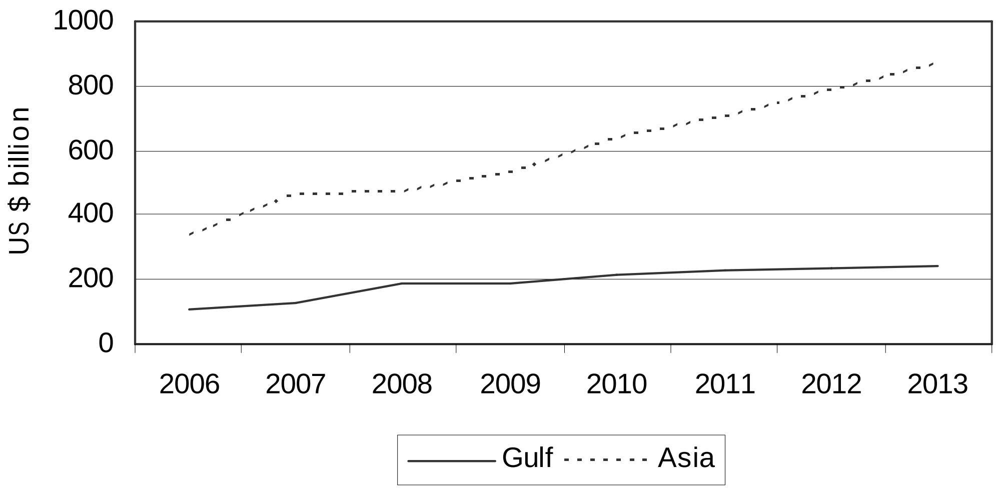
This rapid accumulation of external assets will greatly support the policy objective of many of these countries to develop major financial centres. Obviously, such developments represent sizeable opportunities for the EU27 wholesale financial services sector. But at the same time, the expected rapid growth in competing financial centres will exert substantial competitive pressures on the EU27 wholesale financial services industry.

This trend may well be compounded by the domestic strength of emerging economies, especially those of the BRICs, and a potential resurgence of the international competitiveness of the US wholesale financial service industry.

The strong growth of the emerging economies will stimulate the demand for wholesale financial services in these countries. At issue is the extent to which this demand will be met indigenously or by EU27 wholesale financial services providers.

Overall, in the absence of a strong competitive response from the EU27 wholesale financial services industry, there is a risk that the sector may lose some world market share over the coming years or even face a decline in exports of wholesale financial services. To illustrate the potential impact of such a development, the implications for the EU27 wholesale financial services industry of weaker than expected growth in exports of financial services in the scenario analysis are examined.

Figure 36: Actual and projected current account balances by advanced Asian economies[1] and Gulf States + Saudi Arabia, US $ billion, 2006 to 2013



Note: Advanced Asian economies comprise China, Hong Kong, Korea, Singapore and Taiwan
Source: IMF World Economic Outlook, April 2008

Table 27: Cumulative accumulation of current account surpluses, US$ billion 2006-2013

	2006-2008	2009-2013
Advanced Asian Economies	1263.5	3515.4
Gulf States + Saudi Arabia	421.5	1114.8

Note: Advanced Asian economies comprise China, Hong Kong, Korea, Singapore and Taiwan
Source: IMF World Economic Outlook, April 2008

6.4.4 Regulatory developments

Over the coming years, the wholesale financial services industry will feel the full impact of a number of major EU Directives which have recently been implemented. First and foremost among these is the *Markets in Financial Instruments Directive* (MiFID), which touches on many aspects and activities of wholesale financial markets. This has opened up competition in securities trading by abolishing the national rules of many Member States under which trading of equities had to take place on regulated exchanges.

The combination of MiFID and technological innovations which increase the speed of choice of trading location and trade execution may well result in a significant restructuring of the securities trading market place. Many market players such as trading, clearing and settlement infrastructures, broker-dealers, custodians, and investors, for example, will be affected by these developments.

The forthcoming Solvency II Directive will import capital adequacy requirements into the insurance sector. The Capital Requirements Directive, which came into force in 2007, may well result in other financial institutions having to face adjustments to this Directive, as regulators throughout the world aim to adjust and modify the Basel II capital adequacy system to prevent a repeat of the developments which led to the current crunch.

The regulatory fall-out from the credit crisis may well not be limited to modified capital adequacy requirements as regulators and policy-makers are currently debating many other issues viewed as having contributed to the crisis, such as the role of rating agencies, the remuneration of staff taking risk positions and senior management more generally, and the role of hedge funds, for example.

At the present time, it is not clear which, if any, of the issues currently debated in various policy fora will actually lead to regulatory change, and what impact such change is likely to have on the wholesale financial services industry in terms of output and employment.

Whilst one may argue that any additional regulation will be costly in terms of tying up economic capital and stifling financial innovation, it is possible that additional, proportionate and targeted measures may be required to restore confidence and stability in the system.

Nevertheless, there is a high risk that, on balance, regulatory developments will impact negatively on the growth prospects of the sector; this point is explored further in the scenario analysis.

6.4.5 Changes in business models

One of the key consequences of the current credit crisis is the questioning of the validity of the “originate and distribute” business model which supported the rapid expansion of securitisation and redistribution of risk from the originator to many other financial and non-financial institutions.

This business model resulted in a sharp expansion of activity within the financial sector itself. Some of this activity is unlikely to continue into the near future, due to a more sluggish demand for the supporting financial products (asset backed securities, etc.) and a re-valuation of the riskiness and viability of the business model.

It is likely, however, that once the current credit crunch is overcome, securitisation of a number of assets will still be viewed as beneficial for both the originator and the acquirer of securitised assets. The only difference is likely to be that the originator will be required to keep a portion of such assets on its own books possibly the less creditworthy, to ensure that the interests of the acquirer and originator remain well aligned.

Thus, when considering the medium term outlook of the wholesale financial services industry, it is reasonable to assume that, over the next few years, the level of activity within the wholesale financial service industry flowing from the reliance on the "originate and distribute" business model will reduce.

Therefore, one of the scenarios below explores the implications of a reversal of the level of activity to the level observed a few years back prior to the rapid take off of securitisation.

6.5 Four scenarios

To assess the impact of various potential developments on the medium-term future of the EU27 wholesale financial services industry, we present below the implications of four different scenarios. This assessment was made with a small model of the EU27 wholesale financial services sector. The model relates the GVA of the wholesale financial sector in each Member State to its key drivers and determining factors.

Scenario 1: the benign world scenario

In this scenario, we assume that the recovery of the EU27 economy proceeds at the pace predicted by the IMF over the medium term.

Despite increasing competitive pressures from wholesale financial services centres located outside the EU27, the sector's overall competitiveness does not decrease and exports of wholesale financial services from the EU27 continue to grow in line with the overall level of activity in the EU27 wholesale financial services sector.

In reaction to the credit crisis, a number of changes are made to the EU27 regulatory framework for wholesale financial services, but the modifications are relatively minor in terms of economic impact. Such new regulatory measures include, for example, guidelines concerning the remuneration of staff and management in the EU27 wholesale financial services sector, and tighter supervision of wholesale financial services undertakings. In this scenario, however, no measures are included which render capital adequacy requirements more stringent.

The scenario does foresee a considerable reduction in the reliance on the "originate and distribute" model as the viability and profitability of the model is re-assessed. Relative to a scenario with no such change, the reduced emphasis on the "originate and distribute" model will have a negative impact on the level of activity in the EU27 wholesale financial services sector, as securitisation and financial engineering activity will be much reduced.

The impact of such a change is modelled as a one-off downward level shift in 2009 in the ratio of wholesale financial services GVA to economy-wide GVA to a level last observed in 2004, the year before securitisation started to expand very rapidly. Thereafter, the growth in wholesale financial services GVA is mainly driven by the outlook for the economy as a whole.

The implications of this scenario for the EU27 wholesale financial services industry are relatively benign. In our view, however, the probability that such a scenario is actually likely to materialise is relatively low, in the order of 20%.

Much more likely, we believe, is scenario 2 below.

Scenario 2: the challenging world scenario

In this scenario, the EU27 wholesale financial services industry faces a number of serious challenges over the coming years.

The EU27 economy is assumed to expand at the same pace as in the previous scenario and the "originate and distribute" model falls out of favour.

The scenario, however, assumes that a number of regulatory changes are made which require undertakings in the EU27 wholesale financial services industry to hold more capital in support of their activities and limit their scope to engage in certain activities. Relative to a scenario with no such regulatory changes, the level of activity in the EU27 wholesale financial services sector is reduced, due to the higher cost of doing business. Everything else being equal, from 2009 to 2012, the tightening of the regulatory environment in itself cuts by about half the growth in the ratio of wholesale financial services GVA to economy-wide GVA.

Moreover, the sector becomes significantly less competitive internationally and exports of the EU wholesale financial services sector are assumed to remain stagnant at their 2007 level. In contrast, in the previous scenario, these exports were assumed to grow in line with the level of activity in the wholesale financial services sector. Everything else being equal, this weaker export performance alone dampens significantly the overall activity level in the sector. For example, by 2012, the sector's GVA is almost 4.5% lower than in a scenario in which exports of EU27 wholesale financial services grow in line with domestic wholesale financial services activity.

As noted, in our view, scenario 2 depicts a more likely future of the EU27 wholesale financial services and we estimate the probability of such a scenario (or a very similar one) to be of the order of 40%.

Scenario 3: the stressful world scenario

This scenario compounds the sector's woes assumed in scenario 2 by predicting in addition a weaker economic outlook than the one shown by the latest IMF projections, which themselves are judged by some observers to be perhaps unduly pessimistic.

Nevertheless, the inflationary pressures currently present in many economies, and the likely responses of central banks to such inflationary pressures, suggest that a worse-than-currently expected economic growth outlook cannot be totally ruled out.

Therefore, the present scenario explores the implications for the EU27 wholesale financial services sector of such a weaker economic outlook, in a context in which the sector already faces a number of serious challenges, such as loss of international competitiveness and tighter regulation.

Relative to the economic outlook in the previous two scenarios, annual growth in economy-wide GVA is half a percentage point lower each year over the period 2009 to 2012.

This reduction in economy-wide growth to below potential growth over the medium term has a substantial impact on the EU27 wholesale financial services sector due to its high cyclical sensitivity. This high cyclical sensitivity means that any shock (positive or negative) to the EU27 economy is transmitted more than proportionally to the EU27 wholesale financial services sector. As a result, just on account of the weaker economic growth, by 2012 the sector's GVA is almost 12% lower than it would be otherwise.

While we do not view such a scenario as the most likely scenario, we believe that its probability is far from low. Overall, in our opinion, the probability that scenario 3 will actually materialise is of the order of 25%.

Scenario 4: the positive surprises scenario

While the first three scenarios focus on the various issues and challenges that the wholesale financial sector will face in the years ahead, it is important to note that the prospects for the EU27 wholesale financial sector could be much better.

To explore the implications of such a more positive outlook, we assume in this fourth scenario that, over the period 2009-2012, economic growth in the EU27 will be actually half a percentage point higher than assumed in the first two scenarios. This in itself significantly boosts the level of activity in the EU27 wholesale financial services sector.

Moreover, this fourth scenario assumes that: a) future regulatory changes will have no, or only a very limited, impact on the level of activity in the EU27 wholesale financial services sector; and, b) the sector maintains its international competitiveness.

In addition, in contrast to the previous three scenarios in which we assumed that the savings rate does not increase over the medium term, in the present scenario, we assume that the gross private savings rate continues to recover over the projection period, reaching 19.5% in 2012, up from 18.5% in 2007.

This increase in the savings ratio stimulates, among other things, the level of activity in the wholesale financial services industry and, just on account of the higher savings rate, the sector's GVA is 3.4% higher in 2012 than in a scenario in which the savings rate remains unchanged.

While such a scenario may sound overly optimistic, in our view it cannot be completely ruled out as the EU27 economy and wholesale financial services sector may prove to be much more resilient than generally expected. Nevertheless, in light of the many more negative developments likely to face the sector, the probability that this optimistic scenario is actually likely to materialise is low. We attach a probability of 15% to such a scenario.

6.6 Analysis of the scenarios

The near term outlook

The first key result to note is that under all scenarios, the level of EU27 wholesale financial services GVA in 2009 falls below the level reached in 2007 (see Table 28).

The magnitude of the decline in 2009 relative to 2007 depends on the type of shocks affecting the sector. Scenario 3 is the scenario with the worst outlook for the EU27 wholesale financial services sector.

Scenario 3 is the one in which the EU27 wholesale financial services does not only downsize in response to the 2007 credit crisis, but also faces a tighter regulatory environment and suffers from a loss of international competitiveness in a context of weaker-than-currently projected economic growth. In addition, there is a significant move away from the "originate and distribute" model. All these factors combine to push down by more than 11% the level of EU27 wholesale financial services from 2007 to 2009.

Indeed, in scenario 3, the EU27 wholesale financial services sector's decline in 2009 is more than twice as large as in the "benign world" scenario (scenario 1), in which the EU27 wholesale financial services industry is assumed only to downsize and change its business model.

The results reported in Table 28 also show that the EU27 wholesale financial sector will experience a decline in economic activity in 2009 relative to 2007, even under a more-favourable-than-currently-projected economic climate (i.e. scenario 4 of stronger economic growth, higher savings rate, limited regulatory change and no loss of international competitiveness).

The bottom-line is that the near-term outlook for the EU27 wholesale financial services sector does not appear to be very encouraging. The scenario with the highest probability (scenario 2) shows a decline of 8.3% in the GVA level of the EU27 wholesale financial services sector from 2007 to 2009.

Table 28: Level of GVA (in 2007 Prices) of EU27 wholesale financial services sector under different scenarios, € billion, 2007-2012

	2007	2009		2012	
	Level	Level	% change 2007 to 2009	Level	% change 2009 to 2012
Scenario 1	225.4	214.5	-4.8%	244.0	13.7%
Scenario 2	225.4	206.9	-8.3%	224.0	8.4%
Scenario 3	225.4	200.2	-11.2%	194.5	-2.9%
Scenario 4	225.4	219.6	-2.6%	254.6	15.9%
Weighted average of the 4 scenarios, using probabilities of each as weight	225.4	208.6	-7.5%	225.2	8.0%

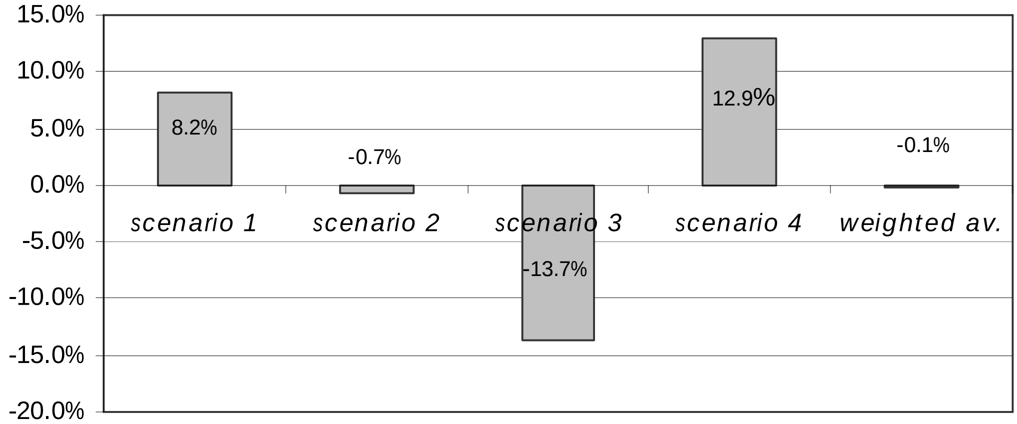
Source: London Economics

The medium-term outlook

The outlook for the EU27 financial services sector is much more varied between scenarios over the medium term.

In scenario 3, the combination of more stringent regulation, loss of international competitiveness, and weak economic growth, continue to depress the level of economic activity of the EU27 wholesale financial services sector over the medium term. As a result, the sector's GVA falls a further 2.9% from 2009 to 2012 (see Table 28) and is 13.7% lower in 2012 than in 2007 (see Figure 37).

Figure 37: Cumulative growth in EU27 wholesale financial services GVA (at 2007 prices) from 2007 to 2012

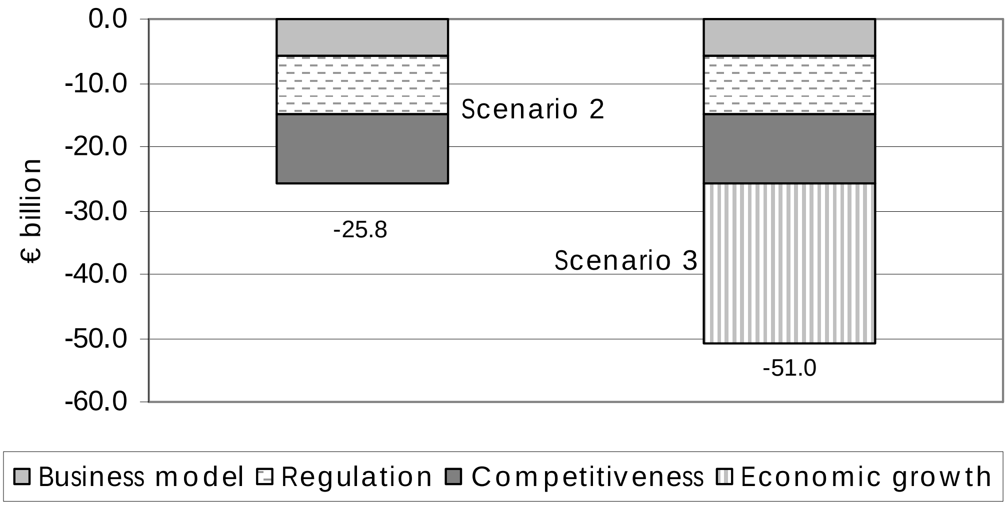


Source: London Economics

Overall, in scenario 3, the level of EU27 wholesale financial services is €30.9 billion (at 2007 prices) lower in 2012 than in 2007. In comparison to the pre-crisis outlook, the sector's GVA level is €51 billion lower in 2012 than would have been anticipated a year ago, with a weaker economic outlook accounting for about half of the downward adjustment (see Figure 38),

That being said, in the most likely scenario (scenario 2), the EU27 wholesale financial services sector recovers much more robustly after 2009 as the positive impact of renewed economic growth more than offsets the effects of tighter financial sector regulation, loss of international competitiveness and lower securitisation activity resulting from the shift away from the "originate and distribute" model. This more robust recovery allows the sector to recover almost all the ground lost in 2008 and 2009, and by 2012, the sector's GVA is only 0.7% (or €1.5 billion at 2007 prices) below its 2007 level.

Figure 38: Contribution of key drivers to scenarios 2 and 3 – change in 2012 level of EU27 wholesale financial services GVA (at 2007 prices) relative to pre-crisis outlook

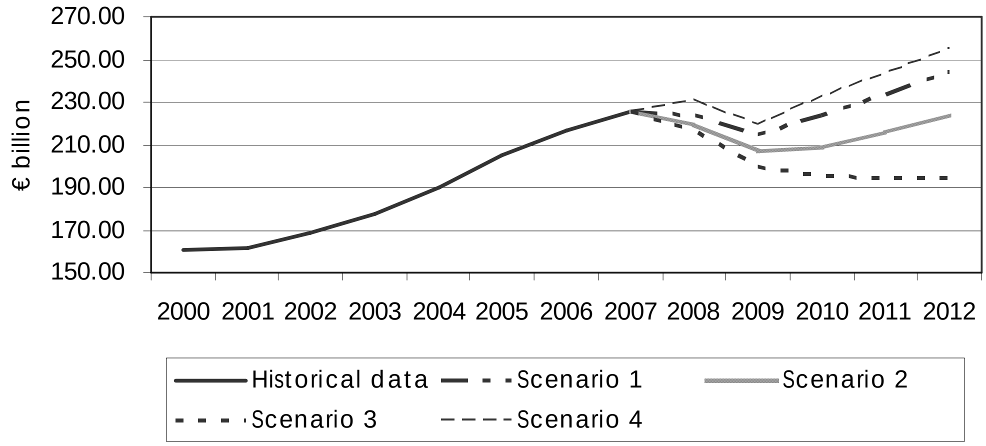


Source: London Economics

In the "benign world" scenario (scenario 1) and the "positive surprises" scenario (scenario 4), the EU27 wholesale financial services sector is not impacted on by any negative factors beyond 2009 and grows rapidly again following the completion of the downsizing which is being implemented in response to the 2007 credit crisis. The sector's post-2009 rebound is particularly pronounced in scenario 4 (see Table 28).

In both of these scenarios, the sector's GVA level (at 2007 prices) in 2012 exceeds its 2007 level by a substantial margin and is between €20 to €30 billion higher (at 2007 prices) than in the most likely scenario (scenario 2) (see Figure 39).

Figure 39: Actual and projected level of EU27 wholesale financial services GVA (at 2007 prices), 2000 to 2012



Source: London Economics

The results of the scenario analysis presented above vividly highlight the uncertain outlook facing the EU27 wholesale financial services sector over the coming years and the potentially negative impact of a number of critical factors. The following section examines the ways in which the wholesale financial services sector in the different Member States are likely to be affected in the four scenarios.

The sector's outlook in different Member States

The structure of the wholesale financial services sector varies substantially across Member States, with wholesale and investment banking being much more predominant in a limited number of Member States, especially the UK, and to a somewhat lesser extent in France, Germany, Italy and Spain.

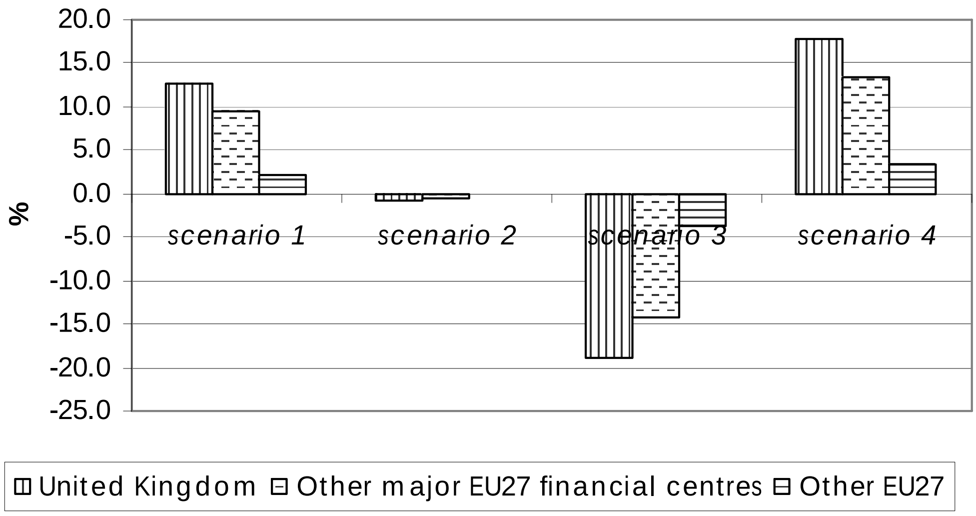
The wholesale and investment banking sub-sector is likely to bear the brunt of the downsizing and any regulatory tightening. Therefore, the wholesale financial services sectors of Member States with larger wholesale and investment banking sub-sectors are likely to be impacted disproportionately in comparison to the wholesale financial services sectors in the other Member States.

Moreover, the level of financial services exports also varies across Member States. As a result, the impact of the loss of international competitiveness by the EU27 wholesale financial services industry will also be felt differently across Member States.

In order to assess the differential impact of the shocks built into scenarios 1 to 4, the EU27-wide impact has been disaggregated by three groups of Member States. These are; the UK; a group of four other European Member States (France, Germany, Italy and Spain) with a relatively large wholesale and investment banking sub-sector; and the other EU Member States.

In all four scenarios, the wholesale financial services sector being the most affected – not just in a negative sense – is the UK sector (see Figure 40). This reflects the importance of wholesale and investment banking in the UK wholesale financial services sector. As an example, in scenario 3, the UK sector's GVA in 2012 is expected to be 19% below its 2007 level while the EU27 wholesale financial services as a whole shows a decline of only 13.7% (see Table 29).

Figure 40: The four scenarios at Member State level - cumulative growth in EU27 wholesale financial services GVA (at 2007 prices) from 2007 to 2012



Source: London Economics

Other major financial wholesale financial services sectors in the EU (France, Germany, Italy, and Spain) are also significantly affected in the various scenarios but somewhat less than the UK sector. As an example, on average, the level of activity in these four sectors in scenario 3 (the worst case scenario) is 14.3% lower in 2012 than in 2007, a slightly larger decline than the EU-wide decline of 13.7% (see Table 29)

The impact on the wholesale financial services sectors of the other EU27 Member States is much more limited, with the percentage change in the

GVA level of wholesale financial services from 2007 to 2012 ranging from -3.7% to +3.5% across the four scenarios. This contrasts with the outcomes for the UK wholesale financial services sector, which range from -19.0% to + 17.8%, and the range for the EU27 financial services sector from -13.7% to 12.9% (see Table 29).

Table 29: Level of GVA (in 2007 Prices) of EU27 wholesale financial services sector under different scenarios in different Member States, percentage change from 2007 to 2012

	Scenario 1	Scenario 2	Scenario 3	Scenario 4
United Kingdom	12.7%	-0.9%	-19.0%	17.8%
Other major EU financial sectors[1]	9.5%	-0.6%	-14.3%	13.4%
Other EU27 financial sectors	2.2%	-0.1%	-3.7%	3.5%
EU27 wholesale financial services sector	8.2%	-0.7%	-13.7%	12.9%

Notes: France, Germany, Italy and Spain
Source: London Economics

7 Conclusions

In 2007 and 2008, the wholesale financial services sector experienced a credit crunch of unprecedented severity in recent times; the sector is likely to continue to be affected by the fall-outs of the crisis over the coming years.

While the first half of 2007 saw very high levels of activity in all the wholesale financial services sub-sectors, the onset of the credit crunch in late summer and early fall of 2007 sharply reduced activity in many wholesale financial services sub-sectors through the second half of 2007. This slowdown persisted and even became more pronounced in a number of cases through the first half of 2008.

It should, however, be noted that the level of activity in the EU27 wholesale financial services sector as a whole reached a new record level for 2007, despite the marked weakness in many wholesale financial sub-sectors in the second half of 2007. Its gross value added in 2007 is estimated to have reached €225 billion, or 32.4% of worldwide wholesale financial services GVA. Employment in the EU27 wholesale financial services also rose to a new record high of 1.4 million.

The short term prospects for the sector are, however, much more subdued. It is highly likely that the current retrenchment of the sector and the on-going employment cutbacks will reduce the overall level of activity and employment in the EU27 wholesale financial services sector in 2008 and 2009 to a level well below the peak reached in 2007.

The scenario analysis presented in the report explored the implications for the EU27 wholesale financial services of different evolutions of a number of key drivers of the sector, namely the overall level of economic activity, domestic savings rates, the response of regulators to the credit crunch and its fall-outs, the international competitiveness of the sector and the reliance on the “originate and distribute” model.

The results of the scenario analysis highlight the great uncertainty surrounding the medium-term outlook for the EU27 wholesale financial services sector with the expected level of GVA (at 2007 prices) ranging from being almost 13% higher in 2012 than in 2007 in the most optimistic scenario to almost 14% lower in the most pessimistic scenario. In the scenario viewed as most likely, the sector’s GVA in 2012 is still 0.7% below its 2007 level. It should be noted that over the longer term, the industries’ prospects remain sanguine, given its overall global competitiveness and importance.

As the wholesale and investment banking sub-sectors of the EU27 wholesale financial services sectors are likely to be the most affected by the credit crisis and its on-going fall-out, Member States with relatively large wholesale and investment banking sub-sectors such as the United Kingdom and, to a somewhat lesser extent France, Germany, Italy and Spain, will feel the brunt of the slowdown in the sector.

The scenario analysis highlights the frailty of the sector, and while some regulatory adjustments and corrections may be necessary over the coming years, it is crucial that any such measures be measured and proportionate so as to avoid putting undue strains on a sector which is already weakened and facing many internal and external pressures.

Glossary

BIS	Bank for International Settlements
BRICs	Brazil, Russia, India and China
ECVA	European Private Equity and Venture Capital Association
FESE	Federation of European Securities Exchanges
GDP	Gross Domestic Product
GVA	Gross Value Added
IMF	International Monetary Fund
ISFL	International Financial Services London
OTC	Over-the-counter
SIV	Special Investment Vehicles
SWF	Sovereign Wealth Fund
UCITs	Undertakings for Collective Investments in Transferable Securities
WTO	World Trade Organisation

List of Tables

List of Figures

The City of London Corporation

The City of London is exceptional in many ways, not least in that it has a dedicated local authority committed to enhancing its status on the world stage. The smooth running of the City's business relies on the web of high quality services that the City of London Corporation provides.

Older than Parliament itself, the City of London Corporation has centuries of proven success in protecting the City's interests, whether it be policing and cleaning its streets or in identifying international opportunities for economic growth. It is also able to promote the City in a unique and powerful way through the Lord Mayor of London, a respected ambassador for financial services who takes the City's credentials to a remarkably wide and influential audience.

Alongside its promotion of the business community, the City of London Corporation has a host of responsibilities which extend far beyond the City boundaries. It runs the internationally renowned Barbican Arts Centre; it is the port health authority for the whole of the Thames estuary; it manages a portfolio of property throughout the capital, and it owns and protects 10,000 acres of open space in and around it.

The City of London Corporation, however, never loses sight of its primary role – the sustained and expert promotion of the 'City', a byword for strength and stability, innovation and flexibility – and it seeks to perpetuate the City's position as a global business leader into the new century.

DOMINE DIRIGE NOS
CITY OF LONDON