EU CAPITAL MARKETS: A NEW CALL TO ACTION

ANALYSIS OF THE SIZE AND DEPTH OF CAPITAL MARKETS IN EUROPE IN THE CONTEXT OF SOME OF THE BIGGEST SOCIAL AND ECONOMIC CHALLENGES FACING THE EU

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> Member states, EU authorities, and the European banking and finance industry need to inject more urgency across Europe into building bigger and better capital markets. This report identifies five of the biggest social and economic challenges facing the EU, analyses whether EU capital markets are in a position to address these challenges, and outlines a small number of high-priority steps to accelerate capital markets development.
A new call to action

At New Financial we have been making the case for bigger and better capital markets in Europe for nearly a decade. This annual benchmarking report on the size and depth of EU capital markets helps us track progress. The good news is that we can measure some welcome developments: capital markets in the EU are bigger and deeper than they were ever before. The not-so-good news is that they are still not as developed as they could or should be.

This year our report focuses on three simple questions:

• What are the big social and economic challenges that the EU needs capital markets to help address?
• Are EU capital markets in a position to address them?
• If not - and in most cases the answer is ‘not yet’ - what are the big levers that the EU and individual member states can pull to change this?

After many years of talking, drawing up strategies, and developing action plans, Europe now needs to step up its game. It is high time for individual member states, EU authorities, and the wider European banking and finance industry to inject more urgency across Europe into building bigger and better capital markets. Member states in particular need to start taking some of the tough decisions required to develop their own capital markets and to build capacity from the bottom up.

The potential benefits are huge: more developed capital markets in Europe could increase the financial wellbeing and security of millions of EU citizens now and in the future; finance the sort of innovation, growth, and high potential companies that Europe needs; help finance the transition to net zero; and help the EU play a bigger and more impactful role on the global stage.

On the flipside, there would be dire consequences if Europe does not get its house in order and further delays building bigger and capital markets.

The first part of the report first discusses how capital markets can help the EU to address some of the biggest challenges it is facing. The second section includes our annual benchmark of EU capital markets and measures their size and depth in 2022. We then take a look at what has (and has not) changed in EU capital markets and provide a call to action to decision makers at all levels to help them develop capital markets at a national and at an EU level.

We hope this research provides relevant insights and we are always interested in your thoughts and questions. I would like to thank Christopher Breen for collecting and analysing the wealth of data that underpins this report, William Wright for his guidance and feedback, Dealogic, Invest Europe, and Preqin for providing access to their data, and Deutsche Bank for partnering with New Financial and supporting this important project. Any errors are entirely my own.

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Here is a short summary of the report:

1. **A new call to action**: the EU economy needs all the help it can get in the wake of Covid, Russia’s invasion of Ukraine, the energy crisis, global economic slowdown, rising interest rates, and stagnating growth. Building bigger, deeper, and more integrated capital markets in Europe is more urgent than ever.

2. **Five big challenges**: in the coming decades the EU will need to i) successfully transition to net zero ii) better support innovation and growth iii) give companies better access to more sources of funding iv) support an ageing population v) secure and advance its role on the global stage. These challenges are complex but present a once-in-a-generation opportunity to transform the lives of millions of EU citizens.

3. **Not quite there yet**: more developed capital markets are not the obvious answer to all of the challenges the EU is facing, but the EU will not be able to address its biggest challenges without them. To develop European capital markets, member states, EU authorities, and the wider banking and finance industry should focus more on ‘capital markets’ than ‘capital markets union’; more on outcomes than legislative initiatives; and more on what individual member states can and should do themselves than on EU-wide solutions.

4. **Bigger and deeper**: EU capital markets have rapidly grown in the past few years. Relative to GDP they have grown by nearly 50% since 2014 and are deeper than ever - but they are still not as developed as they could or should be. In the face of economic headwinds it will be challenging to maintain this growth.

5. **An uneven picture**: every year this report measures the depth of EU capital markets in different sectors of capital markets activity in all EU member states, and every year we see a huge range in depth that shows little sign of narrowing. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or the EU and the UK, and is one of the reasons why harmonising EU capital markets is necessary but challenging.

6. **A concentrated market**: after Brexit, France and Germany have become the largest and second largest (or vice versa) EU markets in 13 out of 21 capital markets sectors in terms of value. Given the size of the two economies, this is unsurprising and demonstrates the potential if France and Germany get serious about developing their capital markets and building further capacity.

7. **A focus on Sweden**: in many respects, Sweden is the poster child for EU capital markets. For the first time since we started working on this annual report, capital markets in Sweden are deeper than they are in the UK. Over the past few years, the depth of capital markets has grown much faster in Sweden than in the rest of the EU. This growth has been driven by venture capital and private equity activity as well as strong equity markets.

8. **The reliance on banks**: companies in the EU are still heavily reliant on bank lending for their funding despite some progress over the past decade. In the face of economic headwinds, structural challenges, and regulatory reform, banks will be unable to provide the necessary funding for European companies on their own.

9. **Capital markets without capital?** Deep pools of long-term capital such as pensions, insurance assets, and direct retail investment are the starting point for deep and effective capital markets. But pensions assets in the EU are much smaller than in comparable markets and concentrated in just three EU economies. Shifting more savings from bank deposits to investments would deploy more capital to support the economy, jobs, and growth.

10. **A burning platform**: it is time to inject more urgency across Europe into building bigger and better capital markets and there would be dire consequences if Europe does not do so - lower financial security and wellbeing for millions of EU citizens, a smaller economy, a slower transition to net zero, and a smaller Europe on the global stage.
The size and depth of capital markets in Europe

There is a lot of data in this report, and it would be pretty exhausting to read it all in one go. This section provides ten key takeaways on the size, depth, and growth potential of European capital markets.

1. THE GLOBAL PERSPECTIVE

Decline in the EU’s share of global capital markets activity from 2006 to 2022

The EU’s share of global capital markets activity has nearly halved over the past fifteen years and is significantly smaller than its share of global GDP. Other regions and countries have pushed ahead in developing their own markets which could draw away companies, jobs, and capital from the EU.

2. FINANCING INNOVATION AND GROWTH

Ratio of US to EU venture capital investment activity from 2018 to 2022

5.2x

The amount of early-stage investment in the EU has accelerated since 2020 but is not on par with peer economies. The value of venture capital deals in the US is 1.1% of the size of the total US economy. In the EU, it is 0.3% of the size of the EU economy.

3. TOO RELIANT ON BANK LENDING

Bank lending as a share of corporate borrowing in the EU in 2022

3/4

Despite some progress over the past decade, companies in the EU are still heavily reliant on bank lending for their funding and it is often the only choice rather than one of many options.

4. THE PENSIONS PROBLEM

The Netherlands, Denmark, and Sweden’s combined share of EU pension assets

62%

The Netherlands, Denmark, and Sweden combined account for nearly two thirds of the EU’s pension assets - €3tn in 2022 alone - but only 12% of EU GDP.

5. GOOD PROGRESS

Share of total capital markets activity that was ‘ESG’ in the EU in 2022

27%

The value of ESG capital markets activity in the EU increased from €136bn in 2018 to nearly €700bn in 2021 and 2022, but this is not enough investment to meet the EU’s climate targets.
KEY TAKEAWAYS

6. BIGGER AND DEEPER

The growth in capital markets depth in the EU between 2014 and 2022

EU capital markets are bigger and deeper than they were before CMU was launched in 2015. In terms of size, the value of activity in nearly all sectors of capital markets has increased between 2014 and 2022. In terms of depth, EU capital markets are deeper than they have ever been.

The multiple between the EU’s most and least developed capital markets

There is a wide range in how developed capital markets in individual EU member states are. Luxembourg’s capital markets are 35x deeper than Latvia’s, while Dutch markets are twice as deep as in Italy. The range between member states is far greater than the range between the EU and the UK.

7. A FRANCO-GERMAN DUOPOLY

Outstanding corporate bonds in France account for 38% of the EU’s total corporate bond market

France and Germany combined account for more than 50% of EU activity in five sectors (insurance assets, value of corporate bond market, assets under management, corporate bond issues, value of equity trading) and for more than 45% of activity in another five. France is the largest market in 12 sectors, Germany in six.

8. A WORLD LEADER

The EU’s share of global ESG capital markets activity in 2022

ESG is the one area where the EU’s share of global markets activity exceeds its share of global GDP (18%). The EU’s sustainable finance taxonomy serves as a benchmark for other regions and key institutions such as the International Sustainability Standards Board have chosen the EU as their home.

9. THE POSTER CHILD

The size of the Swedish stock market relative to its economy in 2022

Sweden’s capital markets are now deeper than the UK’s and give an idea of what EU capital markets could look like: the value of the Swedish stock market was 144% of Swedish GDP in the last year. Other areas of activity where Sweden excels are IPOs, pension assets, and venture capital deals.

10. ROOM FOR GROWTH

Additional capital available across the EU if households moved a fraction of their cash savings into investments

Households in the EU keep a third of their financial assets in cash. If they increased their asset allocation to investments such as stocks, bonds, or funded pensions by just five percentage points this would unlock an extra €1.8tn (11% of EU GDP) that could support investment, innovation, jobs, and growth.
The job is not done - yet

I welcome this annual report on the state of EU capital markets and the Capital Markets Union (CMU). New Financial has consistently provided high quality insights on European financial markets, and this report is another valuable contribution.

This year marks the 30th anniversary of the EU single market which underpins Europe’s prosperity. Market integration has been boosted by Economic and Monetary Union. But the single market for capital lags behind.

There is no doubt that CMU is essential for the EU’s growth and prosperity. CMU will provide businesses with more sources of funding - and investors with more opportunities. While banks remain important, especially for SMEs, more innovative or risky companies can struggle to find financing and often leave Europe as they grow. To strengthen Europe’s competitiveness, especially in strategic areas like clean tech and digitalisation, CMU is a must. CMU is vital for the transition to sustainability and the huge amounts of investment required.

We have made good progress on the legislative side. Last December we introduced a new Listing Act to make the EU a better destination for listing. We have launched an ambitious retail investment strategy to empower consumers to invest in EU capital markets, while ensuring they are treated fairly. We’re not shying away from more structural barriers either. To foster integration and investment across the single market, we proposed common EU rules to make it easier for investors to claim back excess withholding tax. Insolvency proceedings can take up to seven years in some Member States, so proposed new EU insolvency rules will bring more efficiency and predictability.

But we’ve still got work to do. The European Parliament and the Council need to finalise ongoing negotiations on the Commission’s proposals. The Commission will support these and encourage everyone to keep ambition high. In April this year, the Commission, the European Parliament and the Swedish and Spanish Presidencies of the Council of the EU jointly renewed our commitment to CMU. I am also encouraged by the recent strong commitment by EU leaders to make further progress.

Some difficult questions remain. Does supervision work efficiently across the EU? How can CMU contribute more to the sustainability of pensions? And how can we unlock progress at national level in areas where the EU has limited legal responsibility? More will need to be done, also by Member States and the financial sector itself.

What we need to do is keep the ultimate benefits in mind. CMU will deliver a more competitive European financial system, better able to finance innovative companies of all sizes, support the transition to sustainability, withstand economic shocks and support the EU’s global vision for regulation and international standards.

Mairead McGuinness
European Commissioner for Financial Services, Financial Stability, and Capital Markets Union
Why we need capital markets to unlock Europe’s competitiveness

We are living through epochal changes. Conflicts dominate geopolitics, new blocs are forming. All eyes are on the US and China. While Europe has the economic potential to keep up, it needs to be much more ambitious in shaping its own future. Successfully transforming to a sustainable, digitalised economy is the precondition for competing on this new global stage.

How we finance that transition will also determine the EU’s financial autonomy. We need a funding framework that enables our economies, companies and SMEs to compete effectively. That is why the news is welcome that long-standing calls for the capital markets union are increasingly being heard by politicians, but progress clearly remains too slow in practice.

Europe’s share of global capital markets has constantly decreased from 18% in 2006 to 10% in 2022. Further reductions need to be avoided at all costs; they come even as the demand for additional funding channels is increasing dramatically. According to the European Commission, Europe requires €620bn of investments annually to meet the Green Deal objectives and €125bn annually to close the investment gaps for digital transformation. Any funding needed for the reconstruction of the Ukraine comes on top of this.

While European banks currently provide most financing in Europe, they can’t bridge the entire gap within the existing regulatory framework. European capital markets, which in contrast to the US have played a minor role, are the most important lever to move Europe forward.

Only an integrated, open and liquid capital market will enable Europe to mobilise private capital on the scale we need to transform our economy. Or to put it positively: the capital markets union is the biggest growth programme that Europe can and needs to undertake - essentially at no costs.

This benchmark report by New Financial provides essential insights for European policymakers to take Europe into the future. They should consider it essential reading as they gear up for the European Parliament elections in June 2024 and the change-over of the European Commission in October 2024. Integrated, open and liquid European capital markets secure prosperity for companies and citizens alike. They are a strategic asset in the 21st century and will be essential for increasing Europe’s competitiveness.

Christian Sewing
Chief Executive Officer
Deutsche Bank
The scale of the challenge

The challenges facing the EU economy and society are complex and multi-faceted but they present a once-in-a-generation opportunity to transform the lives of millions of EU citizens. Here we outline five of the biggest challenges facing the EU and discuss the role capital markets can and should play in tackling those challenges for the benefit of the EU economy and millions of individuals.

1. The transition to net zero

With climate change becoming a climate emergency and Russia’s illegal invasion of Ukraine in 2022 disrupting critical energy supplies, achieving net zero has become a renewed priority for the entire continent. The EU has already raised significant amounts of capital to address net zero, but governments and banks cannot solve the problem on their own. The EU needs to further accelerate the financing of sustainability.

2. Financing innovation and growth

While early-stage investment and IPO issuance in some EU member states has accelerated in recent years, the EU as a whole struggles with investing in, scaling, and retaining innovative growth companies. Without a healthy base of high growth companies, the EU will find it difficult to tackle the challenges of artificial intelligence, net zero, and providing meaningful jobs to a highly educated population.

3. A more diverse range of funding

Despite some progress over the past decade, companies in the EU are still heavily reliant on bank lending for their funding and it is often the only choice rather than one of a range of financing options. In the face of economic headwinds, structural challenges, and regulatory reform, banks on their own will be unable to provide the necessary current and future funding that European companies need.

4. Supporting an ageing population

Many countries in the EU are facing a demographic time bomb. Today, there are three people of working age for every pensioner in the EU. By 2050, there will be less than two workers for every pensioner. This will put a lot of pressure on the EU’s prevalent pay-as-you-go pension systems, with measures to stabilise these such as funded pension schemes not well understood or unpopular.

5. The EU on the global stage

The EU has an ambition to be a global superpower, but the EU’s capital markets are punching below their weight. The EU’s share of global capital markets activity has nearly halved over the past fifteen years and is significantly smaller than its share of global GDP. Other regions and countries have pushed ahead in developing their own markets which risks companies, jobs, and capital leaving the EU.

Source: EIB, Preqin, Dealogic, ECB and national central banks, OECD
The transition away from fossil fuels

The EU has established itself as a global leader in financing sustainable activities but is still far from the level of financing that it needs to achieve its own climate targets. Fig.1 i) shows that the EU raised nearly €700bn in total ESG financing in 2022, but only about three-quarters of that was climate-focused, and there are varying degrees of ‘greenness’ within the nearly €500bn in identifiable ‘green’ financing. When just looking at financing that is specifically for ‘green’, the EU needs to more than double the amount of financing it is dedicating to reaching net-zero - an effort that, if realised, would enable the EU to reach greater levels of strategic autonomy and provide the world with a benchmark by which to achieve a green economy.

Fig.1 ii) shows that as a percentage of total capital markets activity, overall ESG financing (not just ‘green’ financing) went from being 6% of activity to being more than a quarter, highlighting how sustainable financing has become an essential part of the EU economy and capital markets in just five years. Identifiable ‘green’ financing has not just been based on labelled green bonds, but also vanilla bonds with ‘green’ use of proceeds, and ‘green’ companies raising capital on equity markets, which exemplifies the diverse range of capital markets activity that is available to finance the transition.

While governments and banks are essential players in financing net-zero, it is capital markets that will be crucial toward reaching the €1tn annual mark. Recent efforts around the sustainable finance taxonomy, the NextGenerationEU initiative and its green bond framework, and the REPowerEU initiative have moved the EU forward in financing its goals and have centred (and depended on) capital markets as an engine of green growth. Building on these initiatives has become even more important ever since Russia’s invasion of Ukraine in 2022 added a security dimension to the energy problem.
Scaling innovation and growth

The EU desperately needs to finance more innovation and growth at scale and support both the digital transformation of the EU economy over the coming decade and the sort of high potential companies that will help drive an economic recovery. While the EU is not short of innovation and ideas, too many of these companies struggle to secure the sort of funding they need to scale up. They are often forced to turn to US and other investors for funding. There is nothing wrong with companies choosing where to raise money, but it should be a choice, not the only available option.

The amount of early-stage investment in the EU has accelerated since 2020, but Fig.2 highlights how that welcome growth has stalled. The growth in early-stage investment has not been on par with economies such as the US where the value of venture capital deals is 1% of the size of the total US economy. Later in the funding journey, relatively few companies in the EU choose to list on stock exchanges in the EU. Relative to GDP, IPO issuance in the EU has flatlined over the last five years, while in the US issuance has more than tripled.

When companies choose to list elsewhere, the EU does not only lose businesses but also the infrastructure and the environment around them: valuable tax contributions, highly skilled talent, and innovations and ideas that are key to creating further jobs and growth. Losing a listing means losing many of the spillover effects associated with high potential companies. If the EU is serious about creating high growth companies to rival global firms based in the US or Asia, the EU and member states will need to get serious about financing them and help put capital markets in a position where sourcing capital from domestic investors becomes a realistic option.
A stubborn dependency on bank lending

While there are some encouraging signs that show that companies in the EU have begun to reduce their reliance on bank lending over the past few years, the EU economy is still heavily exposed to a struggling banking sector. Capital markets can provide a valuable additional source of financing for the right EU companies that complements traditional bank lending and provides companies with a wider range of sources of potential funding. The EU’s economy is still too reliant on bank lending and companies are more limited than their US counterparts in diversifying both the sources of the capital they use and the terms over which they borrow.

Fig.3 shows the extent to which companies in the EU rely on bank lending as a source of funding. While the share of corporate bonds in corporate borrowing in the EU increased from less than a fifth to nearly a quarter over the last ten years, it does not dramatically tip the scales. More worryingly, on some metrics the EU has gone backwards: in 2022 EU companies relied more on bank lending than at any time since 2014. While a part of this can be explained by the collapse in the bond and equity markets that occurred in 2022, it shows the extreme stickiness of bank lending in the EU.

Addressing the EU’s reliance on bank lending and lack of capital markets financing will require all stakeholders at EU and member state levels to have some tough conversations around whether those companies in the EU that want and need capital to invest in their businesses have sufficient access to a diverse range of short and long-term funding; whether banks in member states are healthy enough to provide that funding over the course of an economic cycle; and what other sources of funding could step in to fill that potential gap.
The European pensions problem

The starting point for deep and effective capital markets is deep pools of long-term capital, but the size of pools of capital in the EU is a long way off where they could and should be. The most striking difference between the EU and comparable markets is the size of pension assets. Low levels of pension assets in the EU are creating a dual problem: first, EU citizens face uncertain futures with inadequate retirement incomes; and second, EU capital markets miss out on a large potential supply of domestic capital that could be put to work and help finance innovation, jobs, and growth.

Fig. 4 shows the size and growth of pension assets in the EU. The good news is that in absolute terms they have nearly doubled in the last ten years. The not-so-good news is that as a percentage of GDP pension assets in the EU are much smaller than in many other comparable economies. And the problems do not stop there: almost two-thirds of the EU’s pension assets are disproportionately concentrated in the Netherlands, Denmark, and Sweden. For reference: the Netherlands, Denmark, and Sweden combined account for only 12% of EU GDP. Germany, France, Italy, and Spain make up 63% of EU GDP, but only around a fifth of pension assets.

Pay-as-you-go has been the go-to pension model in many EU countries and provided many pensioners with a good retirement income. But the model has come under pressure. The alternative model is funded pensions where contributions are invested to build a fund that is withdrawn in retirement. Done right, they can provide better retirement incomes, reduce public pension expenditure, and support the economy in much needed areas such as investment in infrastructure and innovation - ask the Netherlands, Denmark, and Sweden.

Source: New Financial analysis of OECD data
Making capital markets work for the EU

The EU is one of the world’s largest economies, but its capital markets are punching below their weight. From 2006 to 2022, the EU’s share in global capital markets activity has nearly halved, while other regions broadly maintained or increased their share (even if you adjust for currency fluctuations, the EU’s share of global activity fell by a third). The EU accounts for nearly a fifth of global GDP but only 10% of global capital markets activity. In virtually every sector the EU’s share of global activity is less than its share of global GDP, which limits the EU’s ability to project its influence on the global stage.

The EU has the potential to be a superpower (and, in some areas such as trade, is a superpower) and its ambitions reach across economic realms into foreign policy, security, defence, culture, regulation, and other areas. For the EU to achieve these ambitions, it will need strong capital markets. Bank lending alone will not drive the transition to net zero, nor will an unattractive funding environment make it more likely for innovative companies to invent the technologies of tomorrow in the EU. It also makes it more difficult for the EU to shape future global regulation and common standards in banking and finance when it only represents a small and shrinking share of global capital markets activity.

The good news is that the EU has demonstrated that it can take a leading role in capital markets. Fig.5 shows that activity in ESG is the one sector where the EU’s share of the global markets significantly exceeds its share of global GDP. The EU’s sustainable finance taxonomy serves as a benchmark for other regions that are developing their own taxonomies, and key institutions such as the International Sustainability Standards Board (ISSB) have chosen the EU as their home. If the EU can be a world leader in one sector, what is holding the EU back from developing itself as a key actor in others?
Tough decisions ahead

The EU has made some good but unspectacular progress in developing its capital markets. It is now time for member states, EU authorities, and the wider banking and finance industry to inject more urgency across Europe into building bigger and better capital markets: they should focus more on ‘capital markets’ than ‘capital markets union; more on outcomes than legislative initiatives; and more on what individual member states can and should do themselves than on EU-wide solutions. Here is a short priority list of ten ideas to help them do this.

1) Addressing the challenges

More developed capital markets are not the obvious answer to all of the challenges the EU is facing, but the EU will not be able to address its biggest challenges without them.

>>> Making sustainability clearer: to ensure that the EU can maintain and expand its leadership in ESG financing, it will need to build on its work around its sustainable finance taxonomy and provide clearer definitions around what is ‘green’, ‘ESG’, and ‘transition’ so that finance flows can accelerate, rather than delay, the transition to net zero.

A helpful role that governments and the European Commission could play is providing investors with ready-made projects that are clearly ‘green’ and ensure that regulation and bureaucracy is not getting in the way of getting these sustainable projects off the ground (for example, a wind farm not being built due to overburdensome permit regulations.). And just as the ‘green’ label exists in the bond market, policymakers and business leaders would be Wise to create a similar distinction in the loan and equity markets where labels are not as clear or do not exist at all.

>>> Connecting capital with growth: creating a solid base of innovative and high growth companies will require making the EU a place where companies can easily access early-stage capital. Removing barriers to investment and signalling to investors where and how to invest in growth would give the EU a leg-up in connecting capital with innovation. Public sector vehicles in EU member states such as France (Bpifinance) and Germany (High-Tech Gründerfonds) have helped channel investment towards innovative companies, while countries such as Sweden and Estonia have succeeded in creating the proper tax incentives and fostering talent through extensive social support or friendly visa regimes.

>>> Building out pools of capital: deep pools of long-term capital such as pension and insurance assets are the starting point for deep and effective capital markets, but pools of capital in the EU are much smaller than in the US, UK, Canada, or Australia. Shifting more savings from bank deposits to investments would deploy more capital to help create jobs, fund innovation, and support wider economic growth, and a good starting point is pensions.

The level of pension assets in any give EU member state is entirely a national political and social issue. There are plenty of tools to increase them such as compulsory funded pensions, auto-enrolment, and adequate contribution levels, but pension reforms are often difficult, and it can be politically challenging for member states to try and take inspiration from the UK or the US. The good thing is that they do not need to: there are very good examples of countries in the EU itself that have developed deeper pools of long-term capital and well-functioning pension systems. The Netherlands, Denmark, and Sweden all have mandatory funded pensions, a collective approach with efficient vehicles, political and public support for their pension systems, and good financial outcomes for pensioners.

>>> Reducing reliance on bank lending: in many EU countries the banking system is an almost integral part of local market customs and traditions - with all the downsides that come with a high reliance on bank lending such as less access to more liquid and deeper sources of capital or less resilience in the event of a financial shock. One argument that member states could make to their business communities is that by freeing up the balance sheets of banks (with larger corporations making more use of the capital markets to raise funds), banks could focus on lending to smaller companies that need it the most. Freeing up banks to support SMEs is more vital than ever.
2) A renewed focus on capital markets
Capital markets in the EU need a new narrative with a bolder, clearer, and more focused vision: rooted in addressing some of the huge economic challenges faced by the European economy, and framed in concrete and tangible terms.

>>> From the bottom up: building bigger, deeper, and more integrated capital markets in Europe requires a combination of EU-wide ‘top down’ measures to encourage harmonisation and national-level ‘bottom up’ measures to increase capacity. While the focus in the past few years was perhaps a bit too much on the ‘top down’ part, bigger and better capital markets will not be built in Brussels but in each and every member state.

There is (virtually) no reason why Austria cannot have the same sort of pension system as Denmark or why Bulgaria cannot have the same healthy funding environment for start-ups as Estonia. Whenever we ask what can be done at an EU level to boost capital markets development, we also need to ask what member states can do to support and develop capital markets given that comparable economies within the EU have already shown what can be achieved.

>>> An honest debate: too many countries in the EU have avoided an honest debate about the sustainability of their financial systems, from the viability of pay-as-you-go pensions or the efficacy of an economy dominated by bank lending provided by a struggling banking industry struggling. The European Commission should encourage member states to conduct a social and economic impact assessment of their existing capital market systems to inform the development and prioritisation of bottom-up measures.

>>> Making a better case: the benefits of deeper and more liquid capital markets have too often been framed in abstract and technical language, such as ‘increasing the shock absorption capacity of the EU economy’ or ‘improving the allocative efficiency of finance’. (Even we do it.) While this is important, it would be better to frame the case to member states in concrete and accessible terms: highlighting the tangible benefits of capital markets to businesses and citizens in practical terms such as ‘this is what it means for jobs, investment, and growth in your country’.

>>> Education, education, education: low levels of financial literacy, engagement, and trust in the financial industry in Europe (along with a cultural reluctance to talk about money) translate into low levels of financial wellbeing, confidence, and resilience. The EU and many member states have done some great work in developing a framework around financial literacy, but this needs scale and consistency to have a big impact. A starting point to address this could be the introduction of financial health checks at important moments in life.

>>> CMU 3.0: the EU’s capital markets union (CMU) strategy has tried to solve too many problems at once. A shorter and simpler action plan based on a smaller number of clearly prioritised projects with the biggest economic impact and combining top-down and bottom-up initiatives would provide a more practical programme for the next decade. It is important to avoid expending too much political capital on the wrong problems and focus instead on a smaller number of ‘first principle’ problems that help address the biggest challenges the EU is facing. With a new European Commission and European Parliament coming in 2024, there is a big opportunity to refocus CMU on a smaller number of key challenges.
**EU capital markets: size & depth**

In this section we look at the size and depth of EU capital markets in each EU country across 26 sectors of activity, discuss how companies in the EU are funded, and analyse the available pools of long-term capital in the EU.

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A wide range

A good starting point to understand how developed capital markets in the EU are is the depth of capital markets in individual member states and at the EU level. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or between the EU and the UK. Fig.6 shows the wide range in the depth of capital markets across 26 sectors of activity in each country.

The most significant development this year is that Sweden moved ahead of the UK for the first time in our series of annual benchmarks. In 2022, Sweden was second only to Luxembourg in terms of the deepest capital markets in the EU, more than twice as deep (250) as the EU average (100), and the third deepest overall when including the US. Capital markets in the US reduced in depth relative to the EU (going down to 392). Luxembourg’s capital markets - although very small in size with around 2% of EU activity - maintained their position as the deepest capital markets due to its role as a regional hub for investment funds and international bond issuance.

The driving force behind Sweden’s rise and the UK’s fall has been Sweden’s strong activity levels in equity issuance, particularly IPOs, and Sweden’s stock market size relative to its economy, while the UK experienced a sudden drop in its corporate bond markets (issuance and stock) which in turn affected the value of pension and insurance assets. This was partly driven by the liability-driven investment (LDI) crisis in October 2022 in the UK.

There are three broad groups of countries in this analysis: wealthier countries in the north-west of the EU such as Sweden, the Netherlands, and France have the most developed capital markets in the EU; a number of countries have capital markets that are relatively well developed but still less than the EU average and do not reflect the size of their economies (such as Germany, Italy, Spain); and finally, there is a long tail of smaller economies with less developed markets where building from the bottom up and learning from best practice in other markets could make a big difference.
### DEPTH OF EU CAPITAL MARKETS BY COUNTRY

This table is a ranking of the overall depth of capital markets in each EU country and the UK across 26 sectors of activity. It is divided into four groups, from most developed (top quartile) to least developed (bottom quartile).

Note: the numbers in brackets show last year’s position of each country in the ranking based on revised 2021 data.

#### What is the depth of capital markets across EU countries?

This table is a ranking of the overall depth of capital markets in each EU country and the UK across 26 sectors of activity. It is divided into four groups, from most developed (top quartile) to least developed (bottom quartile).

**Introduction**

A new call to action

**EU capital markets: size & depth**

What has changed?

**Discussion**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Country</th>
<th>Overall depth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 (=)</td>
<td>Luxembourg</td>
<td></td>
</tr>
<tr>
<td>2 (3)</td>
<td>Sweden</td>
<td></td>
</tr>
<tr>
<td>3 (2)</td>
<td>UK</td>
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</tr>
<tr>
<td>4 (=)</td>
<td>Netherlands</td>
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<tr>
<td>5 (=)</td>
<td>France</td>
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<tr>
<td>6 (7)</td>
<td>Denmark</td>
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<tr>
<td>7 (8)</td>
<td>Ireland</td>
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<tr>
<td>8 (6)</td>
<td>Finland</td>
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<tr>
<td>9 (14)</td>
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<td>10 (9)</td>
<td>Spain</td>
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<td>11 (12)</td>
<td>Germany</td>
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<td>12 (11)</td>
<td>Italy</td>
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<td>13 (10)</td>
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<td>16 (15)</td>
<td>Estonia</td>
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<tr>
<td>17 (=)</td>
<td>Austria</td>
<td></td>
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<tr>
<td>19 (=)</td>
<td>Greece</td>
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<tr>
<td>20 (21)</td>
<td>Lithuania</td>
<td></td>
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<tr>
<td>21 (20)</td>
<td>Poland</td>
<td></td>
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<tr>
<td>22 (=)</td>
<td>Hungary</td>
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<tr>
<td>23 (=)</td>
<td>Croatia</td>
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<td>24 (25)</td>
<td>Bulgaria</td>
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<tr>
<td>25 (28)</td>
<td>Slovakia</td>
<td></td>
</tr>
<tr>
<td>26 (=)</td>
<td>Romania</td>
<td></td>
</tr>
<tr>
<td>27 (24)</td>
<td>Slovenia</td>
<td></td>
</tr>
<tr>
<td>28 (27)</td>
<td>Latvia</td>
<td></td>
</tr>
</tbody>
</table>

**Pools of capital**

**Equity markets**

**Bond markets**

**Asset management**

**PE, VC & crowdfunding**

---

![Diagram showing depth of capital markets across EU countries](image.png)
A concentrated market

Large and deep capital markets provide a more diverse, flexible, and resilient source of funding for the wider economy than bank lending alone. One of the most striking, but perhaps unsurprising, aspects of EU capital markets is that depth does not always translate into size.

Fig. 8 shows the three largest EU markets in each sector measured by total value of activity over the three years to the end of 2022. In 13 out of the 21 individual sectors we analysed, France and Germany are the largest and second largest (or vice versa) markets. In terms of size, France and Germany combined account for more than 50% of EU activity in five individual sectors, for more than 45% of activity in another five, and for 41% of total capital markets activity in the EU. This effectively creates a Franco-German duopoly.

France is the largest market in 12 individual sectors and the EU’s largest capital market overall. The country accounts for 38% of the EU’s corporate bond market, 34% of the EU’s private equity fundraising, and 30% of the EU’s assets under management. Germany is the largest market in another six sectors. For reference, France’s share of EU GDP is 17%; Germany’s share is 24%.

Luxembourg, the EU member state with the deepest capital markets by some distance, accounts for 32% of the value of the EU’s investment funds, but this is the only area of activity where Luxembourg can compete with larger markets in terms of size.

Pension assets are the only area of activity where neither France nor Germany are one of the three largest EU markets. The Netherlands, Denmark, and Sweden combined account for nearly two thirds of the EU’s pension assets - €3tn in 2022 alone - but only 12% of EU GDP. Deep pools of long-term capital are the starting point for deep and effective capital markets, and all three countries have capital markets that are more developed than the EU average.

Source: Dealogic, OECD, Insurance Europe, EIOPA, Eurostat, FESE, local exchanges, ECB, BIS, national central banks, EFAMA, Invest Europe
Old habits

While there are some encouraging signs showing companies in the EU have begun to reduce their reliance on bank lending over the past few years, the EU economy is still heavily exposed to a struggling banking sector. Fig.9 shows the extent to which companies in the US, the UK, and the EU rely on bank lending as a source of funding. The good news is that the share of corporate bonds in total corporate borrowing in the EU has experienced a welcome if small increase.

On average, bank lending represents 76% of corporate borrowing for EU companies and bond markets account for 24%. This is the inverse of the US, where bank lending accounts for just 27% of corporate borrowing. In the UK, corporate bonds represent more than a third of all corporate borrowing.

There is a wide range in the level of adoption of corporate bond markets in the big four economies in the EU. In France, corporate bonds represent a significant part of corporate borrowing (33%). Corporate bond markets in Germany, Italy, and Spain are far less developed with companies relying on bank lending for more than 80% of their borrowing.

The reliance on bank lending and the slow progress towards more capital markets financing is more evident in the way EU companies are funded. Fig.10 shows the distributions of liabilities of non-financial companies in the UK, EU, and three of the biggest EU economies.

Bank loans represent more than a quarter of the total liabilities of non-financial companies in the EU, whereas listed shares and debt securities account for a fifth of all corporate financing. EU companies have a preference for unlisted shares and other non-public equity instruments which account for more than 40% of all non-financial corporates’ liabilities. Along with unlisted shares, the EU’s share of listed shares has increased, with countries such as Germany seeing a two percentage points growth from 2014 to 2022.

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**Fig.9 How do companies borrow money?**

Bank lending and corporate bonds as a % of corporate borrowing in the three years to 2014 and 2022 in the US, UK, EU, Franc and Germany

**Fig.10 How are companies funded?**

The distribution of total liabilities of non-financial corporations in the three years to 2014 and 2022 in the UK, EU, France, Germany, and Italy
Capital markets without capital?

The starting point for deep and effective capital markets is deep pools of long-term capital - but households in the EU are almost as dependent on bank deposits as companies are on bank lending. Fig.11 shows how households in the EU invest their financial assets.

Households in the EU divide their financial assets (excluding property) roughly equally in three parts. One third (34%) of their financial assets are in bank deposits - more than double the level in the US. Nearly a third (28%) are held in pensions and insurance products, and the rest is invested directly in other assets such as stocks, bonds, or funds. This ratio has remained virtually unchanged since 2014.

There is a wide range across the EU. In the Netherlands, Denmark, and Sweden the share of bank deposits is relatively small and well below the EU average, with an outsize share held in pensions assets. But in nearly two-thirds of EU member states, the share of bank deposits is above the EU average, ranging from a third to more than 60% of total household financial assets.

While the size of long-term pools of capital in the EU has grown since 2014, pension assets in France and Germany remain relatively low compared to smaller economies with more developed capital markets such as Sweden. If France were to lessen its proportion of bank deposits to that of Sweden, it would free up more than €1tn for pensions and other assets.

Fig.12 shows the total size of financial assets in the US, UK, EU, France, and Germany. Relative to GDP, total financial assets in the US are more than twice as large as in the EU. Between 2014 and 2022, the US saw 29% growth in the size of its long-term capital, while the EU saw growth of only 16%. This is largely explained by the fact that US pensions assets are more than five times the size as in the EU, and direct investments in funds, stocks, and bonds are more than three times the size.

Fig.11 How do households invest their assets?

The allocation of household financial assets (excluding property) in the three years to 2014 and 2022 in the US, UK, EU, France, and Germany

Fig.12 What is the size of pools of capital?

The size of long-term capital in % of GDP in the three years to 2014 and 2022 in the US, UK, EU, France, and Germany, with the number in blue showing total size.
What has changed?

In this section we discuss how the size and depth of EU capital markets have changed since 2014 (one year before CMU was launched) and look at the long-term trend.

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At a glance: EU capital markets since 2014 25
A focus on Sweden 26
The long-term trend 27
The long-term view

Building bigger and deeper capital markets in the EU is a long-term game and will take decades to reach its full effect. This report is not an index that identifies the 'best' capital markets in the EU but highlights where measures are succeeding and where things need to accelerate to develop deeper capital markets. Here is an overview of how capital markets in the EU have (or have not) changed since 2014 and how they are developing:

1. **Bigger**: EU capital markets are growing steadily and are bigger than they were before CMU was launched in 2015. The value of activity in nearly all sectors of capital markets increased between 2014 and 2022, with average growth in nominal terms of nearly 70% across 20 sectors. The growth in pools of long-term capital is particularly welcome, although they still have a long way to go.

2. **Deeper**: EU capital markets are nearly 50% deeper relative to GDP than they were in 2014, and they are deeper than they have ever been (having overtaken their previous peak in 2021). Capital markets in Sweden are now deeper than in the UK after a strong performance in venture capital and IPO activity.

3. **Not as deep as they could be**: EU capital markets are moving in the right direction, but they are not as deep as they could be or need to be. In sectors such as equity issuance and trading, private equity, or M&A activity, the EU market has grown more slowly than the UK. At the same time, the EU has narrowed the gap in depth with the UK in nearly three-quarters of the sectors we looked at.

4. **A range in depth**: every year this report measures the depth of EU capital markets in different sectors of capital markets activity in all EU member states, and every year we see a huge and stubborn range in depth. The range in depth of capital markets across the EU is far greater than the difference in depth between the EU and the US, or the EU and the UK, and this has remained essentially unchanged since 2014.

5. **Not pulling their weight**: of the four largest economies in the EU, only France has capital markets that are deeper than the EU average. This was not always the case: until 2017, Spain had deeper capital markets than the EU average, and capital markets in Germany and Italy have gone backwards relative to the EU average.

6. **Struggling to catch-up**: since 2014, we have identified a long tail of smaller economies mainly in Central and Eastern Europe with the least developed capital markets. Their economies have significant growth potential and have much to gain from deeper capital markets, but with the exception of Estonia and Czechia they have not made a lot of progress in closing the gap.

7. **More integration needed**: building more capacity in domestic capital markets across the EU remains the top priority, but having more integrated capital markets across the EU would be an added bonus so that pensioners in Finland can benefit from economic growth in Austria - and vice versa.

8. **Growth potential**: while the EU’s growth in areas such as venture capital and early-stage investment has been impressive, there is still much room to grow relative to peers such as the US where early-stage investment is three times as big relative to GDP. If the EU had early-stage investment activity at the same level as in the US, there would be an additional €50m for each of the 3,200 companies in the EU that raised VC funding in 2022.

9. **Change is afoot**: things may not move as fast as some had hoped, but capital markets reform has moved up the political agenda across Europe. Recent efforts around developing a consolidated tape and creation of a green bond standard indicate that the EU is slowly making progress.

10. **A new sense of urgency**: the big challenges the EU is facing around the transition to net zero, financing innovation and growth, and supporting an ageing population are a call to action: building bigger, deeper, and more integrated capital markets in Europe is more urgent than ever before.
EU capital markets are bigger and deeper than they were before CMU was launched in 2015. Fig.13 looks at 20 sectors of capital markets activity and shows whether the value of activity and depth relative to GDP have increased since 2014, and if the EU has narrowed the gap in depth compared with the UK.

The value of activity in nominal terms has increased in almost all of the 20 sectors. This is unsurprising given the eight-year time frame. In half of the sectors, value has increased by more than 50%. For example, the value of all EU stock markets in 2022 was €3.8tn bigger on average than in 2014, an increase of 59%.

With average EU inflation between 2014 and 2022 at around 20%, it is concerning to see that the value of high-yield bond issues and all equity issues has fallen in real terms. It is a welcome development, though, that IPOs (including small IPOs) have seen marked improvement as it is critical that companies not just want to grow but also list in the EU.

The depth of EU activity relative to GDP has increased over the same period. Most sectors are deeper than they were in 2014 - apart from the debt markets and equity issues. The depth of bank lending to companies has decreased which is an encouraging sign that companies in the EU are reducing their reliance on bank lending but can also create problems if it is not replaced by capital markets activity.

Venture capital is the standout market. Since 2014, the value of venture capital deals has exploded, with strong growth in 2021. This growth has been driven primarily by Germany, Sweden, and France, with Sweden playing the greatest role relative to the size of GDP.

EU pension, insurance, and household financial assets have increased in both size and depth, and they have narrowed the gap with the UK, but the growth is uneven. While some EU member states recorded triple-digit growth figures, the value of Poland’s pension assets declined by 15% between 2014 and 2022.

### Fig. 13 How have the size and depth of EU capital markets changed?

The change in absolute size and depth relative to GDP in different capital markets sectors in the EU, comparing the three years to 2022 with the three years to 2014. Note: sectors marked with * are more developed relative to GDP than in the UK. Here, traffic lights denote whether the EU has extended or reduced its lead.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Increase in value since 2014%</th>
<th>Increase in depth since 2014%</th>
<th>Narrowed gap vs UK since 2014%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pools of capital</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pensions assets</td>
<td>66%</td>
<td></td>
<td></td>
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<tr>
<td>Insurance assets</td>
<td>38%</td>
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</tr>
<tr>
<td>Household financial assets</td>
<td>48%</td>
<td></td>
<td>*</td>
</tr>
<tr>
<td>Pensions + insurance</td>
<td>47%</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Market / asset values</strong></td>
<td></td>
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</tr>
<tr>
<td>Stock market</td>
<td>59%</td>
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<td></td>
</tr>
<tr>
<td>Corporate bond market</td>
<td>52%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank lending to companies</td>
<td>12%</td>
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<td>*</td>
</tr>
<tr>
<td><strong>Asset management</strong></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Assets under management</td>
<td>88%</td>
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<tr>
<td>Investment funds (by domicile)</td>
<td>104%</td>
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<td>*</td>
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<td><strong>Debt markets</strong></td>
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<td></td>
</tr>
<tr>
<td>Corporate bond issues</td>
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<td></td>
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<tr>
<td>High-yield bond issues</td>
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<td>All equity issues</td>
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<td>IPOs</td>
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<td><strong>Mergers &amp; acquisitions</strong></td>
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<tr>
<td>All M&amp;A activity</td>
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<tr>
<td>Domestic M&amp;A</td>
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<td><strong>Private equity &amp; venture capital</strong></td>
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<td>Private equity funds raised</td>
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<tr>
<td>Private equity activity</td>
<td>158%</td>
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</tr>
<tr>
<td>Venture capital activity</td>
<td>1160%</td>
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</table>
The poster child of EU capital markets

Relative to the size of its economy, Sweden now has the deepest and most developed capital markets of any major economy in Europe - a position that had been held by the UK for as far back as we have been tracking data for this annual report (2006). Swedish capital markets are on average two and a half times deeper than the EU and ahead of the UK which has stagnated at around 2.2 times the EU average. The depth of capital markets in Sweden has tripled since 2014, driven by venture capital deals, private equity fundraising, and IPO issuance.

The Swedish government has connected capital with growth by making it easy to support innovation - allowing not just institutional but also retail investors to play an important role in channelling finance. Thanks to a friendly tax regime, people in Sweden can invest easily in the stock market while business angels have been able to take advantage of tax deductions when investing in SMEs. Sweden’s investor base has channelled their savings into equities, creating a large pool of capital for IPO issuance and driving Sweden to be only second to the UK in 2021 for new European listings in terms of value (although Sweden, along with many other economies throughout the world, experienced a sharp decline in IPOs in 2022).

One of the most critical reforms that Sweden undertook regarding its financial markets has been its decades-long effort to consolidate its pension funds. After pension system reforms in the 1990s and 2000s, Sweden has created a three-tier system that involves a mandatory DC system which complements the occupational pension schemes that cover most people in Sweden. These consolidated Swedish pension funds have positioned part of their assets toward alternative investments, driving the major growth in Swedish VC deals that has occurred over the last five years.
Lights and shadows

EU capital markets are not just deeper than they were before CMU was launched in 2015: they are now deeper than they ever have been. This is good news and shows member states overall are moving in the right direction. But there is still not enough finance available to support the growth of the European economy and significant growth potential remains.

Fig. 14 shows the depth of EU capital markets since 2006 rebased to the EU average of 100 in 2014, one year before CMU was formally launched. With an average depth of 149 in 2022, capital markets are nearly 50% deeper relative to GDP than in 2014, trumping their previous peak in 2021 and continuing their rapid growth after years of stagnation.

In terms of capital markets development, 2022 was a good year for many individual member states, too. In particular, Sweden experienced significant growth in terms of depth for venture capital activity and equity issuance. With 2021 and 2022 having been bumper years, particularly for bond and equity markets, it remains to be seen whether the EU and member states can maintain this depth.

On the downside, bank lending to non-financial corporations in the EU remains far below its 2008 peak. Fig. 15 shows the flow of bank lending since 2006 in total volumes and as a percentage of GDP.

In 2022, non-financial corporations in the EU accessed €3.3tn via loans from banks - nearly a fifth less than the €4.1tn in 2008 and a fall of more than 40% in real terms. While the volume of bank lending in 2022 was higher than it was in 2014, as a percentage of GDP it was slightly lower. This means companies have begun to reduce their reliance on bank lending over the past years, but at the same time capital markets financing is not offsetting the decrease in bank lending yet, underlining the importance of member states across the EU to build capital markets from the bottom up and to make capital markets financing more accessible.
What next?

In this section we outline the benefits of capital markets and provide a series of questions for national governments, finance ministries, and regulators to help continue the conversation around reforming and improving EU capital markets along with building capacity from the bottom up. The questions frame the challenges that we outlined earlier in the report and drill down into immediate and medium-term changes that can make a large impact.

Our final call to action emphasises the urgency to build bigger and better capital markets and paints a clear picture of what might happen if Europe does not do so.

Benefits of capital markets  
Some questions for individual EU member states  
A new sense of urgency
BENEFITS OF CAPITAL MARKETS

A complementary role

Bigger and deeper capital markets can bring many benefits to the European economy and citizens in terms of investment, jobs, and growth. In the face of current social, economic, and geopolitical challenges, this has become even more urgent. Here is a selection of some of the potential benefits of bigger capital markets in Europe:

1. **A wider range of funding**: capital markets provide a valuable additional source of financing for EU companies that complements traditional bank lending and provides companies with a wider range of sources of potential funding. This reduces the economy’s reliance on bank lending and enables companies to diversify both the sources of the capital they use and the terms over which they borrow.

2. **Economic resilience**: capital markets help increase the ‘shock absorption’ capacity of the wider economy. The impact of an economic downturn is transmitted less quickly and directly to individuals in economies with more developed capital markets than those that rely more heavily on bank lending, and they tend to recover quicker.

3. **Access to capital**: capital markets offer the right companies the ability to raise a larger amount of capital at a lower cost and for a longer period than borrowing from their bank. Through equity financing they provide high potential companies - the sort of companies that Europe needs to drive growth, innovation and jobs - with risk capital that banks are not designed to provide.

4. **Increase bank lending capacity to SMEs**: capital markets are not a realistic option for most SMEs, but wider use of capital markets by companies that are large enough to access them can help free up bank balance sheets and enable banks to focus on lending to smaller companies that need it the most. Freeing up banks to support SMEs is more vital than ever.

5. **Capital allocation and standards**: capital markets improve what economists call the ‘allocative efficiency’ of capital by effectively crowdsourcing funding to a wide range of investors and channelling investment to those companies that can make the best use of it. The need to compete for capital and be accountable to investors helps improve discipline, operational standards, corporate governance, performance, and transparency.

6. **More flexible**: while capital raising can come to an abrupt halt in the wake of market disruption, capital markets rebound faster than bank lending. The flow of gross new bank lending in the eurozone fell by a nearly a fifth from 2008 to 2022, but issuance in European bond markets has doubled relative to GDP since 2007.

7. **Long-term returns**: markets can be volatile in the short term but investing in capital markets across a range of assets over the long term generates higher returns than keeping savings in the bank, providing a better future income in retirement. Long-term pension savings also reduce the future economic burden on EU taxpayers and government budgets and help address the demographic time bomb faced by many countries in the EU.

8. **Longer-term investing**: capital markets provide long-term investors such as pension funds and insurance companies with a wider range of assets to invest in that better match their liabilities. Annual pension contributions by employers and employees add up to billions a year that can be put to work supporting the economy in much needed areas such as investment in infrastructure and innovation.

9. **Wealth creation**: capital markets democratise wealth creation by enabling a wider range of people to invest in high growth and successful companies through their investments and pensions, particularly in equity markets. Over time, money that it is invested in capital markets grows faster than money that is deposited in the bank.

10. **Sustainable growth**: Europe needs to invest around €1 trillion a year over the next few decades to address climate change and finance a transition to a more sustainable economy. Bank lending and taxation are not enough: capital markets can close this gap by providing capital at scale through a wide range of instruments.
Driving growth from the bottom up

Bigger and better capital markets will only happen if the EU successfully introduces ‘top down’ measures at an EU level to improve harmonisation and individual member states complement this with ‘bottom up’ initiatives to increase capacity. Here are a few questions for national stakeholders to encourage debate about what measures member states could take:

1. **Access to funding:** do companies in your country who want and need capital to invest in their business have sufficient access to a diverse range of short- and long-term funding? How reliant are companies on bank lending? Are banks in your country healthy enough to provide that funding over the course of an economic cycle? And what other sources of funding could step in to fill that potential gap?

2. **Savings vs investments:** how much of your citizens’ financial assets are held in bank savings and how much is invested? Are you confident that bank savings are the best way to help drive long-term wealth creation particularly in a new world of higher inflation? What would be the potential impact (including the benefits and trade-offs) if a significant part of those savings were moved into other forms of investment?

3. **Pensions:** how sustainable is your pension system across all three pillars (state, workplace, and private pensions)? What is the balance between pay-as-you-go and funded pensions and how does that compare with other EU member states? What measures could you take over 25 years to shift that balance? What impact would it have on your economy and public finances if more people were making annual contributions to their pensions and building a bigger pool of long-term capital that could be invested in your economy?

4. **Market infrastructure:** is your market infrastructure (stock exchanges, settlement, clearing etc) appropriate for an economy and market of your size? What barriers - if any - does your market infrastructure present to the future development of your financial markets and to cross-border investment in your economy?

5. **Venture capital & risk capital:** do high potential companies in your country that could drive job creation have enough access to early-stage risk capital? Do they have sufficient access to other sources of risk capital, and if so, which sources? Is the level of equity funding through the stock market and IPOs in your economy sufficient to meet demand? And are there measures that you could take to boost supply and demand?

6. **Cross-border investment:** how important is cross-border investment to your economy? Can domestic sources of capital provide all the funding your economy needs? What barriers - if any - do your tax, regulatory, and legal systems present in terms of your economy’s attractiveness to foreign investors?

7. **Regulation:** how well regulated is your economy and your financial system? On what metrics? How does this compare to other countries in the EU and the rest of the world? What barriers - if any - does your regulatory system and implementation of EU law present to growth and investment?

8. **Tax:** what is the balance in your economy between the taxation of labour and capital, and between debt and equity? Do you have any tax measures that implicitly or explicitly disincentivise investment? Without fundamentally changing your tax system, are there changes you could make to incentivise more investment? If so, which countries could provide examples of what does and does not work?

9. **Legal system:** how comfortable are you with where your country ranks in international rankings of the rule of law, complexity, and timeliness of legal process, and issues such as corruption and transparency? What barriers does your legal system present in terms of investment and growth and cross-border flows of capital?

10. **Regional cooperation:** how could regional cooperation with other EU member states help boost your economy? What form might this cooperation take in the banking and finance sector? Do you have the right systems and structures in place to encourage and facilitate this sort of cooperation?
1. **Lower financial wellbeing:** Europeans are pretty good at saving, but without bigger capital markets and a new approach to long-term saving and investing the financial security and wellbeing of Europeans is at risk. An economic and social model that relied on strong welfare policies has worked well for many people in many EU member states for many decades. But with increasing life expectancy, stagnating real incomes, the rising costs of long-term care, lower home ownership rates for younger people, and a falling dependency ratio of workers to pensioners, this model has come under pressure.

If member states do not address this problem fast, it will cause trouble for millions of individuals in the next few decades, and it is not unreasonable to think that this might lead to an increase in social tensions and wider inequality. Without bigger capital markets, the only way to stabilise crumbling pay-as-you-go pension systems is by increasing contribution rates or retirement ages, or by lowering retirement incomes - but all of these are unpopular measures.

2. **A smaller economy:** depending on how you look at it, the EU can be considered to be the largest economy in the world, but growth rates are sluggish and the EU is struggling to foster, support, and develop the sort of high growth companies that it needs for further innovation, jobs, and growth. There is not enough risk capital in the EU to fund these types of companies which forces businesses to source capital from foreign investors or move their operations abroad altogether. In the long term, this can lead to economic stagnation.

3. **A slower transition:** Europe is on a very good path to becoming the first net zero continent, but even in the EU progress towards net zero is not as fast it could or should be, and one reason for this is that there is a shortfall in funding. Capital markets play a key role in addressing climate change - not just in financing projects that get us closer to net zero but also in managing risk and helping to mitigate and adapt to some of the irreversible consequences of climate change that we are already seeing. Without bigger capital markets in Europe, where do member states think the additional money needed to accelerate the transition to net zero will come from? All eyes are on Europe when it comes to greening an economy, and if the EU fails to succeed, it is hard to imagine how other regions in the world can achieve it.

4. **A smaller Europe:** contrary to popular opinion, the EU is an effective force on the global stage. It is the world's largest trading bloc, the world's largest single market, and the euro is the world's second most used currency for trade, finance, and reserve building. Outside of economic affairs, the EU's response to Russia's invasion of Ukraine demonstrated its influence in diplomacy and foreign policy. But a lot of this is at risk if Europe becomes a continent that cannot maintain high living standards for its citizens, cannot support high growth companies and innovation, and misses its own ambitious climate targets. Bigger and deeper capital markets in the Europe are directly linked to the EU's position on the global stage.

5. **Just do it:** the good news is that there is no need to reinvent the wheel, to come up with a new technology, to practice some form of alchemy, or to do something that no-one else has ever done before. The EU and individual member states have all the tools that they need to build bigger and better capital markets at their disposal - they just need to stop admiring the problem and start doing something about it.

This will not be easy: there are many underlying philosophical, cultural, and political reasons for resistance to capital markets development in the EU. But in reality, there is nothing intrinsic to being in the EU, or having a social democratic model with high levels of and a well-developed welfare state, that means you cannot have well-developed capital markets. Ask Sweden, the Netherlands, or Denmark.
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Our research on capital markets:
Here is a selection of some of our recent reports on capital markets:

Capital markets in the UK: a new sense of urgency
Financing innovation: early stage investment in the EU
Benchmarking ESG in banking and finance
Building EU capital markets from the bottom up
From Big Bang 2.0 to Edinburgh
Financing the transition
A new narrative
Our sample:

We analyse the size and depth of capital markets in the following 26 different sectors of activity in all 27 EU member states. This year, we have added domestic funds by domicile to our analysis.

- **Pools of capital**: pensions assets, insurance assets, household retail investments (excluding pensions, insurance, cash deposits & unlisted equity)
- **Equity markets**: stock market value, initial public offerings, secondary equity issues, convertible bonds, SME growth markets, equity trading volumes
- **Bond markets**: corporate bond market value, bond market value, investment grade bond issuance, high-yield bond issuance, bank lending relative to corporate bonds
- **Loans & securitisation**: value of outstanding securitisation, securitisation issuance, leveraged loan issuance
- **Assets under management**: assets under management, all investment funds by domicile, domestic investment funds by domicile
- **Corporate activity**: M&A by target nationality, M&A by acquiror nationality, domestic M&A
- **Private equity, venture capital & crowdfunding**: private equity activity, venture capital activity, private equity fundraising

Measuring depth:

In each sector and country we measure the value of activity as a percentage of GDP on a three-year rolling basis from 2004 to 2022 to iron out the annual volatility in capital markets. To enable a comparison in depth between different sectors, we rebase these percentages in each sector to the EU28 average. We then again rebase the average of all sectors to the EU27 average. We call this the ‘EU’ average and do this to allow for comparisons with previous reports where we used the EU28 average.

For example, the value of stock markets in the EU in the three years to 2022 is 71% of EU GDP. We rebase this to 100, meaning that a country with a score of 50 has a stock market that is half as deep relative to GDP as the EU average, and one with a score of 200 is twice as deep.

While this methodology has the advantage of simplicity, in a handful of countries with a particularly large sector relative to GDP - for example, all investment funds by domicile in Luxembourg - it can distort the overall ranking. To reduce these distortions, we cap each metric at two standard deviations from the mean for every country. This reduces the distortion of a few outsize sectors more fairly than not including the outlying metrics at all.

Measuring growth potential:

In previous reports, we estimated the growth potential in European capital markets and created simple, realistic, and achievable benchmarks for overall growth. We will do this in a separate report that we aim to publish in Q1 2024.