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How London Can Close Gap on Wall Street

By Peter Weinberg
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Having worked in both the London and New York financial communities, I am often asked to compare the Square Mile with Wall Street. Which city will attain the position of global financial centre in the years ahead?

I always find this a difficult question to answer because the Square Mile, in effect, reaches across 13 time zones from Dublin to Vladivostok, as does the span of Wall Street. In addition, liquidity and the movement of capital around the world have become so ubiquitous and pervasive that it is hard to know where London or New York begins and where Tokyo, Shanghai or Hong Kong leaves off. I am not even sure it matters to the sophisticated global market participants where the epicentre is located.

I believe, however, that a number of shifts are occurring in the world that will benefit London quite significantly. Two in particular are worth discussing: the increased flow of financial capital from the Middle East to London and the impact of stock exchange mergers on the City of London.

Saudi Arabia, Iran, the United Arab Emirates, Kuwait and Qatar will generate at least $250bn of revenues in 2006 from the sale of hydrocarbons, according to PFC Energy, the consultants, in Washington. At the end of this year, foreign assets held by these countries will total $900bn, double the level in 2000. If one simplistically assumes that half of future surpluses are invested within the Gulf in infrastructure, power and additional energy development and half is invested in foreign direct investment, US Treasuries, bank deposits, liquid markets and alternative assets, these foreign assets will grow very significantly. Where this capital goes matters.

Due to the historical relationship between the regions and a cultural affinity, Middle Eastern investors have always been comfortable investing in the UK, either directly or as a gateway to Europe. The reaction in the Gulf to the controversy surrounding Dubai Ports World's now-abandoned plan to buy five US ports has been quiet but profound. This, and other situations that will inevitably occur, will on the margin deflect capital away from the US towards the UK.

Even assuming that the chosen currency of oil remains dollars, and the Middle East continues to help fund America's current account deficit through its purchase of US government securities, $50bn to $100bn of Middle Eastern capital could find its way to London over the next several years. The securities markets, hedge funds and private equity firms will be the beneficiaries.

The trend towards mergers of stock exchanges around the world is also likely to benefit London. There was a time when the US stock exchanges hosted the largest initial public offerings in the world. Most of the big capital raisers were based in the US and New York was the unquestioned centre of liquidity. A look at the 25 largest IPOs executed in 2005 suggests that this is no longer the case: nine were listed in Europe, nine were in Australasia, five were in London and only two were in the US. The reason for this is a mix of the geographic location of the issuer as well as the unwanted burdens of Sarbanes-Oxley compliance.

Having said this, liquidity and scale remain superior in the US. Compared with the London Stock Exchange, the New York Stock Exchange has 17 times the number of trades, four and a half times the market capitalisation and two and a half times the value traded. The size of the NYSE compared with the European exchanges is even more significant. Furthermore, the cost of clearance and settlement across Europe for equity securities is five times the cost in New York due to cross-border inefficiencies. All this points to a higher cost structure in London and higher transaction costs to investors, and therefore higher cost of equity to companies.

These two forces – a bias to issue equity outside the US and less scale among the UK and European exchanges – cry out for consolidation. The best result for London would be a merger with one of the US exchanges, which would make an already attractive market cheaper and even more appealing. The only fear would be protectionist reactions from the UK.

We should worry when certain questions are asked, such as: "How can the LSE be owned by a foreigner?" Or "Where will the headquarters of the merged entity be located?" Hopefully, the UK will not fall into the trap of believing that a national champion is good for the Square Mile. What is best for the investor is what is best for London.

The US financial markets enjoy an enormous incumbency advantage as the largest, most liquid and most transparent in the world. However, current trends present a unique opportunity for the City to take a big step forward, by making itself as appealing as possible to enormous flows of foreign investment capital, and driving down the cost of doing business through consolidation.

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