Global Investor Jeffrey E. Garten

Let the Good Times Roll

Ten years ago, when the “Big Bang” hit London, a burst of deregulation reversed years of stagnation in the markets and propelled the City to become one of the world’s biggest and most vibrant financial centers. When we look back on 2007, there is a good chance that it will be remembered as the year of the global big bang, ushering in a new boom in financial
deals from mergers to buyouts to IPOs, in unprecedented numbers and scale, with a quantum expansion of deals across national borders. Whether this phenomenon lasts or whether it ends in a collapsing financial universe—well, that’s another question.

The first flares of the global big bang are already visible. The world’s biggest IPOs are coming out of China, such as the recent $350 billion underwriting deal for the Industrial and Commercial Bank of China, and more are on the way. David Vinar, Goldman Sachs’s CFO, says that the firm’s pipeline of deals is bigger than at any time since the height of the Internet boom. David Rubenstein, founder of the Carlyle Group, recently predicted we would see a $100 billion private equity deal within two years, a size that is almost three times larger than any previous PE investment. Blake Grossman, CEO of Barclay’s Global Investors, says that hedge funds and other exotic investments would soon be classified as “mainstream,” implying new trillion-dollar markets for average investors. Since this summer, U.S. investors in mutual funds have been putting twice as much money into foreign stocks as in domestic shares, a trend that should gain even more momentum as Americans seek more currency diversification. With the greenback falling, moreover, and with America’s foreign debt rising rapidly, look also for an unprecedented wave of foreign acquisition of United States assets.

The world has been building toward this critical moment for some time. Global economic growth has been stronger than at any time since the early 1970s; inflation and interest rates have been low in most parts of the world; transnational investment has mushroomed; trade barriers have stayed low. It’s no accident that financial markets have flourished. Between 2001 and 2004, daily foreign exchange turnover rose to $1.9 trillion, a 7 percent increase, while daily trading in derivatives reached $2.4 trillion, an increase of 74 percent. This year, the value of mergers and acquisitions around the world are set to reach their highest levels since 2000. In 2006, the value of U.S. mutual funds will probably exceed $10 trillion, an increase of 66 percent in the past four years.

Now regulators, central banks and markets around the world are poised to make moves that could turn an expansion into an explosion. In the United States, there is a wariness with the laws put in place after the Enron and WorldCom debacles, with Mercantile Exchange and the Chicago Board of Trade are joining forces to become the world’s largest bourse. Across the Atlantic, the New York Stock Exchange and Euronext will soon become one company, and NASDAQ may swallow the London Stock Exchange. The Tokyo and Korea Exchanges are eyeing a connection, too.

The financial system will have been awash in money for at least the past six years. Neither the European Central Bank nor the Federal Reserve is expected to jack up interest rates significantly. China’s financial surplus, which breached the $1 trillion mark a few months ago, is expected to increase by $100 billion to $200 billion this year. OPEC countries and Russia, even with oil prices down from their mid-2006 highs, are projected to continue running huge current account surpluses.

This year will also see more major industry restructuring and more growth along emerging geographical corridors of international trade, and in new financial capitals. We need look only at the growing consolidation of the steel and mining sectors, the explosion of trade between Latin America and Asia or the growth of financial services in the Middle East and Persian Gulf as harbingers of what is still to come on a larger scale.

The problem is that the global financial system has become too big and too intertwined by loans and risks that are both highly technical and too non-transparent for anyone to really understand. At some point, the party has to end, and the longer it rages, the more painful the reckoning. For 2007, however, it’s a good bet that the good times will roll.

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