McKinsey&Company

McKinsey Global Institute





March 2011

# Urban world: Mapping the economic power of cities

## The McKinsey Global Institute

The McKinsey Global Institute (MGI), established in 1990, is McKinsey & Company's business and economics research arm.

MGI's mission is to help leaders in the commercial, public, and social sectors develop a deeper understanding of the evolution of the global economy and to provide a fact base that contributes to decision making on critical management and policy issues.

MGI research combines two disciplines: economics and management. Economists often have limited access to the practical problems facing senior managers, while senior managers often lack the time and incentive to look beyond their own industry to the larger issues of the global economy. By integrating these perspectives, MGI is able to gain insights into the microeconomic underpinnings of the long-term macroeconomic trends affecting business strategy and policy making. For nearly two decades, MGI has utilized this "micro-to-macro" approach in research covering more than 20 countries and 30 industry sectors.

MGI's current research agenda focuses on three broad areas: productivity, competitiveness, and growth; the evolution of global financial markets; and the economic impact of technology. Recent research has examined a program of reform to bolster growth and renewal in Europe and the United States through accelerated productivity growth; Africa's economic potential; debt and deleveraging and the end of cheap capital; the impact of multinational companies on the US economy; technology-enabled business trends; urbanization in India and China; and the competitiveness of sectors and industrial policy.

MGI is led by three McKinsey & Company directors: Richard Dobbs, James Manyika, and Charles Roxburgh. Susan Lund serves as MGI's director of research. MGI project teams are led by a group of senior fellows and include consultants from McKinsey's offices around the world. These teams draw on McKinsey's global network of industry and management experts and partners. In addition, MGI works with leading economists, including Nobel laureates, who act as advisers to MGI projects.

The partners of McKinsey & Company fund MGI's research, which is not commissioned by any business, government, or other institution.

Further information about MGI and copies of MGI's published reports can be found at www.mckinsey.com/mgi.

# *The City 600* today . . .*

## 1.5 billion

people live in these 600 cities—
22 percent of global population

## $30 trillion

of GDP in 2007—more than half of global GDP

## 485 million

households, with average per capita GDP of

## $20,000

The top 100 cities generated

## $21 trillion

of GDP in 2007—38 percent of the global total

* The City 600 are the top 600 cities by contribution to global GDP growth from 2007 to 2025.

# *. . . and tomorrow*

**2.0 billion**

people will live in these 600 cities in 2025—25 percent of the global population

**$64 trillion**

of GDP in 2025, nearly 60 percent of global GDP

**735 million**

households will live in these cities, with average per capita GDP of

**$32,000**

. . . of which

**235 million**

households in developing world cities will have income above $20,000 per annum

# Executive summary

We live in an urban world. Half of the world's population already lives in cities, generating more than 80 percent of global GDP today. But the urban economic story is even more concentrated than this suggests. Only 600 urban centers, with a fifth of the world's population, generate 60 percent of global GDP. In 2025, we still expect 600 cities to account for about 60 percent of worldwide GDP—but the cities won't be the same. The earth's urban landscape appears to be stable, but its center of gravity is shifting decisively, and at speed. Companies trying to identify the most promising growth opportunities need to be able to map this movement and spot the individual cities where their businesses are most likely to thrive.

Today, major urban areas in developed regions are, without doubt, economic giants. The 380 developed region cities in the top 600 by GDP accounted for 50 percent of global GDP in 2007, with more than 20 percent of global GDP coming from 190 North American cities alone. The 220 largest cities in developing regions contributed another 10 percent—China's cities generated 4 percent and Latin America's largest cities another 4 percent. Across all regions, 23 megacities—metropolitan areas with ten million or more inhabitants—generated 14 percent of global GDP in 2007.

Over the next 15 years, the makeup of the group of top 600 cities will change as the center of gravity of the urban world moves south and, even more decisively, east. One of every three developed market cities will no longer make the top 600, and one out of every 20 cities in emerging markets is likely to see its rank drop out of the top 600. By 2025, we expect 136 new cities to enter the top 600, all of them from the developing world and overwhelmingly (100 new cities) from China. These include cities such as Haerbin, Shantou, and Guiyang. But China is not the only economy to contribute to the shifting urban landscape. India will contribute 13 newcomers including Hyderabad and Surat. Latin America will be the source of eight cities that include Cancún and Barranquilla.

Yet for companies looking for growing markets, locating the most promising cities requires yet another lens beyond just the top cities. To position their portfolios, they should be looking for those urban markets that are likely to contribute most to global growth. For McKinsey's granularity of growth research has shown that the underlying growth (or growth momentum) of the markets where a company's business portfolio is positioned explains two-thirds of that company's revenue growth; only 4 percent of revenue growth comes through gaining share in existing markets.[2] A growing market offers opportunities for incumbents and newcomers alike, and companies that position themselves effectively in fast-growing urban markets are likely to outperform their peers.

The top 100 cities ranked by their contribution to global GDP growth in the next 15 years—we call this group the City 100—will contribute around 35 percent of GDP growth to 2025. And the top 600—the City 600—will generate 60 percent of global

2 Mergers and acquisitions explain the remaining 30 percent. For more detail, see Mehrdad Baghai, Sven Smit, and Patrick Viguerie, "The granularity of growth," *The McKinsey Quarterly*, May 2007 (www.mckinseyquarterly.com).

GDP growth during this period. The importance of the City 600 is demonstrated by the fact that we estimate that the next 400 cities ranked by their contribution to global growth add only about 6 percent on top of the contribution of the City 600. Faster growth in per capita GDP, even more than population growth, is driving the economic expansion of these urban regions. We expect the combined GDP of the City 600 to increase by $34 trillion from 2007 to 2025.[3]

Looking for growth gives us a dramatically different list of target cities. This group includes around 230 cities that do not make it into today's top 600, all of them emerging region cities with current populations of between 150,000 and ten million inhabitants, the so-called *middleweight* cities.[4] These middleweights include many relatively unfamiliar cities such as Ahmedabad, Huambo, Fushun, Medan, and Viña del Mar. We expect the 216 Chinese cities in the City 600 alone to contribute nearly 30 percent of global growth between 2007 and 2025 compared with 3 percent generated by cities in India, which is at a much earlier stage of its urbanization. But it would be a mistake to assume that the growth story lies exclusively in emerging markets—98 rapidly growing North American cities will contribute almost 10 percent of global growth in this period.

Companies now need to ask themselves which cities, and where, will offer the most promising prospects for each of their businesses and how they can best position themselves to capture these market opportunities through their activities and relationships. The fact that many of the new urban economic dynamos entering the City 600 over the next 15 years are not household names underscores the need for companies to look at the world's economic geography at a granular level of detail. Projecting the economic and demographic evolution of cities over the next 15 years is inherently subject to multiple sources of uncertainty and companies need to test the robustness of their business decisions against a broader set of plausible scenarios.

For policy makers, understanding the shifting gravity of the global urban landscape is equally valuable. Our projections describe the urban trends that we expect to unfold from today's environment, but the growth and prosperity of cities critically depend on the way the evolving challenges of cities are managed. Policy makers who anticipate urban trends will not only be better prepared to respond to the increasing complexity of larger cities but can use effective planning and management to help boost the growth prospects of their urban regions. Moreover, diplomatic efforts in support of business need to evolve to reflect the shifting urban world. For embassies, consulates, and high commissions to support their nations' trade interests more effectively, they need to move away from networks of embassies designed around the world as it was in the late 20th century to identifying which cities are likely to shape the 21st century. As illustration, take Wuhan in China that we expect to deliver more than ten times the GDP growth of Auckland. But most countries have an order of magnitude more diplomats in Auckland than they have in Wuhan—if they have any at all in the latter.

Until now, a lack of global data at the city level has prevented companies and policy makers from tracking the evolving role of cities in the global economy and positioning their business and policy activities accordingly. To help close this "white space" in our

3 We measure GDP at a predicted real exchange rate (RER). Please see the appendix for more detail.

4 We divide the middleweights into three categories based on population size. Large middleweights have populations of five million to ten million, midsize middleweights two million to five million, and small middleweights 150,000 to two million.

understanding of the global economy, the McKinsey Global Institute (MGI), McKinsey & Company's business and economics research arm, has built on its extensive body of research on the urbanization of China, India, and Latin America to develop the MGI Cityscope, a database of more than 2,000 metropolitan areas around the world that we believe is the largest of its kind.[5] By analyzing demographic, income, and household trends in these cities, the database offers actionable insights on the choices facing companies looking for new markets and policy makers seeking to improve their urban management and the alignment of their diplomatic efforts with their countries' trade interests. Exhibit E1 shows the top 25 urban areas on a number of key measures included in the MGI Cityscope.

### Exhibit E1

**Top 25 hot spots by 2025**

Cityscope 2025 city rankings

**Bold text** Developing regions
Normal text Developed regions[1]

| Rank | GDP[2] | Per capita GDP[2] | GDP growth[2] | Total population | Children[3] | Total households | Households with annual income over $20,000[4] |
|---|---|---|---|---|---|---|---|
| 1 | New York | Oslo | **Shanghai** | Tokyo | **Kinshasa** | Tokyo | Tokyo |
| 2 | Tokyo | **Doha** | **Beijing** | **Mumbai** | **Karachi** | **Shanghai** | New York |
| 3 | **Shanghai** | Bergen | New York | **Shanghai** | **Dhaka** | **Beijing** | London |
| 4 | London | **Macau** | **Tianjin** | **Beijing** | **Mumbai** | **São Paulo** | **Shanghai** |
| 5 | **Beijing** | Trondheim | **Chongqing** | **Delhi** | **Kolkata** | **Chongqing** | **Beijing** |
| 6 | Los Angeles | Bridgeport | **Shenzhen** | **Kolkata** | **Lagos** | New York | Paris |
| 7 | Paris | Hwasŏng | **Guangzhou** | **Dhaka** | **Delhi** | London | Rhein-Ruhr |
| 8 | Chicago | Asan | **Nanjing** | **São Paulo** | **Mexico City**[5] | **Mumbai** | Osaka |
| 9 | Rhein-Ruhr | San Jose | **Hangzhou** | **Mexico City**[5] | New York | **Delhi** | **Moscow** |
| 10 | **Shenzhen** | Yŏsu | **Chengdu** | New York | **Manila** | **Mexico City**[5] | **Mexico City**[5] |
| 11 | **Tianjin** | Calgary | **Wuhan** | **Chongqing** | Tokyo | Rhein-Ruhr | Los Angeles |
| 12 | Dallas | **Al-Ayn** | London | **Karachi** | **Cairo** | Paris | **São Paulo** |
| 13 | Washington, D.C. | Edinburgh | Los Angeles | **Kinshasa** | **Lahore** | **Kolkata** | Seoul |
| 14 | Houston | Charlotte | **Foshan** | London | **São Paulo** | **Lagos** | Chicago |
| 15 | **São Paulo** | San Francisco | **Taipei** | **Lagos** | **Kabul** | Osaka | Milan |
| 16 | **Moscow** | Durham | **Delhi** | **Cairo** | **Buenos Aires** | **Dhaka** | **Mumbai** |
| 17 | **Chongqing** | Ulsan | **Moscow** | **Manila** | **Luanda** | **Tianjin** | **Cairo** |
| 18 | Randstad | Washington, D.C. | **Singapore** | **Shenzhen** | London | **Shenzhen** | **Hong Kong** |
| 19 | **Guangzhou** | Boston | **São Paulo** | Los Angeles | Los Angeles | **Moscow** | **Taipei** |
| 20 | **Mexico City**[5] | Belfast | Tokyo | **Buenos Aires** | **Colombo** | **Chengdu** | Randstad |
| 21 | Osaka | New York | **Shenyang** | **Rio de Janeiro** | **Baghdad** | **Cairo** | **Shenzhen** |
| 22 | Philadelphia | **Grande Vitória** | **Xi'an** | **Tianjin** | **Shanghai** | **Rio de Janeiro** | **Istanbul** |
| 23 | Boston | Canberra | **Dongguan** | Paris | Paris | **Wuhan** | **Delhi** |
| 24 | San Francisco | Seattle | **Mumbai** | **Jakarta** | **Jakarta** | Los Angeles | **Buenos Aires** |
| 25 | **Hong Kong** | Zurich | **Hong Kong** | **Istanbul** | **Istanbul** | **Buenos Aires** | Madrid |

1 Developed regions comprise the United States and Canada, Western Europe, Australasia, Japan, and South Korea.
2 GDP, per capita GDP in 2025, and GDP growth 2007 to 2025 in predicted real exchange rate.
3 Population below age 15.
4 Households with annual incomes greater than $20,000 in purchasing power parity (PPP) terms.
5 Mexico City Metropolitan Region.
NOTE: For metropolitan regions, we use the first name of the region: e.g., New York for New York-Newark.
SOURCE: McKinsey Global Institute Cityscope 1.0

5 This analysis includes all cities with populations of 150,000 or above in Western Europe and the United States, and cities with populations of 200,000 and above in the rest of the world. We describe all those below these thresholds as small cities, which form part of a small cities and rural areas grouping. For more on our regional perspectives, see *Preparing for China's urban billion*, March 2009; *India's urban awakening: Building inclusive cities, sustaining economic growth*, April 2010 (www.mckinsey.com/mgi). A new report on Latin America, *Building globally competitive cities: The key to Latin American growth* will be published in 2011.

Other findings that emerge from our analysis include:

- Until now, a company strategy focused on developed economies together with emerging market megacities has made sense for many businesses—this combination generates more than 70 percent of global GDP today. But these regions and very large cities in developing economies are likely to generate only an estimated one-third of global growth to 2025. A strategy focused on this combination will be insufficient for companies seeking to position their portfolios for growth.

- Contrary to common perception, megacities have not been driving global growth for the past 15 years. In fact, many have not grown faster than their host economies, and we expect this trend to continue. We estimate that today's 23 megacities will contribute just over 10 percent of global growth to 2025, below their 14 percent share of global GDP today.

- Instead, we see the 577 fast-growing middleweights in the City 600 contributing half of global growth to 2025, gaining share from today's megacities. Worldwide, we will see 13 middleweight cities become megacities by 2025, 12 of which are in emerging markets (the exception is Chicago) and seven in China alone.

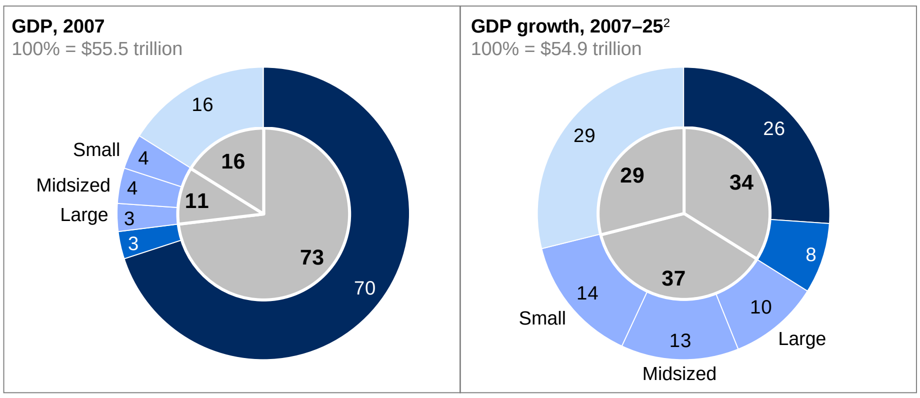
- Emerging market mega- and middleweight cities together—423 of them are included in the City 600—are expected to contribute more than 45 percent of global growth from 2007 to 2025. Across the world, we see 407 emerging market middleweights contributing nearly 40 percent of global growth, more than the developed world and developing region megacities put together (Exhibit E2).

**Exhibit E2**

**Middleweight cities in emerging markets are poised to deliver nearly 40 percent of global growth by 2025, more than the entire developed world and emerging market megacities combined**[1]

Contribution to GDP and GDP growth by type of city

%




1 Megacities are defined as metropolitan areas with ten million or more inhabitants. Middleweights are cities with populations of between 150,000 and ten million inhabitants.

2 Real exchange rate (RER) for 2007 is the market exchange rate. RER for 2025 was predicted from differences in the per capita GDP growth rates of countries relative to the United States.

SOURCE: McKinsey Global Institute Cityscope 1.0

- By 2025, developing region cities of the City 600 will be home to an estimated 235 million households earning more than $20,000 a year at purchasing power parity (PPP). This compares with more than 210 million such households expected in the cities of developed regions. So, even at the higher end of the middle-income segment, there will be more households in emerging market cities than in developed ones.

- Population in the City 600 will grow an estimated 1.6 times as fast as the population of the world as a whole. By 2025, we estimate that the 600 will be home to more than 25 percent of the world's working-age population, 15 percent of its children (aged below 15), and 35 percent of its older population (aged 65 and above).

- However, expanding populations are not the largest drivers of urban growth. In most cities, rising per capita GDP is the major factor, fueled by agglomeration benefits in larger cities and their capacity to attract higher investments and talented workers.

- The City 600 will be home to an estimated 310 million more people in the working-age population by 2025—accounting for almost 35 percent of the expansion of the potential global workforce. Almost all of this increase is likely to be in emerging market cities and two-thirds in the leading cities of the China region and South Asia.[6]

- By 2025, there are likely to be about 13 million more children in these 600 cities than there were in 2007 but with very different trends across regions. An estimated seven million additional children will be in the City 600's Chinese cities compared with 2007, despite the fact that the number of children in China overall is declining. We anticipate that cities in the United States and Canada will have three million more children in urban centers in 2025 than in 2007, but that there will be ten million fewer children in Latin America's large cities.

- By combining demographic and income distribution data, we estimate that the number of children in households with an annual household income above $20,000 is likely to grow more than ten times as fast in the cities of developing regions as those in developed economies. Within the City 600, just over 95 percent of the growth in the number of children within this income group is likely to come from cities in developing regions. By 2025, developing cities are likely to account for nearly 60 percent of children in this income group; cities in the China region, Latin America, and South Asia are likely to represent two-thirds of this share.

- Aging cities are not just a developed country phenomenon. We project that the 423 cities from developing regions will contribute almost 80 percent of growth in the 65-plus age group in the City 600 over the next 15 years. The top 216 cities in China will have 80 million new older citizens. Shanghai is expected to be home to twice as many older people as New York.

6 China region includes cities in China (including Hong Kong and Macau) and Taiwan. South Asia includes cities in Afghanistan, Bangladesh, India, Pakistan, and Sri Lanka.

- Around the world, the size of households is declining, leading to more rapid growth in the number of households. We expect the number of households in the world's leading cities to grow at 2.3 times the rate of global population growth. The City 600 alone is likely to account for 250 million new households. An estimated 85 percent of these households will form in the cities of emerging regions; half of the total will be in China's cities alone. Globally, the three cities that will experience the strongest growth in housing demand will be Beijing, Shanghai, and Tokyo.

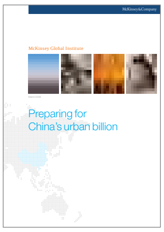
- The economic role of large cities varies widely among regions today—as do their future growth patterns. China's rapid growth is fueled by the continued growth of its megacities and the emergence of new ones. India's urbanization is at a relatively early stage, while Latin America's largest cities are giving way to fast-expanding middleweights. It is clear that there is no "one size fits all" approach to tapping into the urban markets of emerging economies.

- Choosing the right urban markets requires combining granular market intelligence with company-specific information on the potential of different urban geographies and the cost of reaching them. A strategy based on clusters of cities is an attractive option for many companies, particularly in large countries such as China and India that have significant regional differences in their market characteristics.

□ □ □

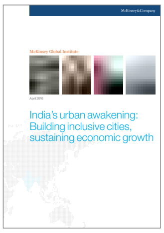
For companies seeking pockets of growth in the world economy and policy makers grappling with the multiple challenges of managing fast-expanding cities, scratching the surface is no longer sufficient. In this report, we draw insights from more than 2,000 leading cities in the world, looking at demographic trends and shifts in the profile of households and incomes. The aim of this deep analysis is to help policy makers to prepare themselves more effectively for the challenges ahead, and companies to identify potential "hot spots" to a sufficient level of detail to calibrate effective, targeted strategy. Our research suggests that we need to shift focus from economies as a whole to cities within them, and beyond high-profile megacities to the most attractive middleweights, particularly in emerging markets.

# Relevant McKinsey Global Institute publications




**Preparing for China's urban billion (March 2009)**

By pursuing a more concentrated urbanization path guided by action to boost urban productivity, China's local and national policy leaders would minimize the pressures of urbanization and maximize the economic benefits of urban expansion.




**India's urban awakening: Building inclusive cities, sustaining economic growth (April 2010)**

India's lack of effective policies to manage its rapid and large-scale urbanization could jeopardize the nation's growth trajectory. But if India pursues a new operating model for its cities, it could add as much as 1 to 1.5 percent to annual GDP growth.


**Building globally competitive cities: The key to Latin American growth (Forthcoming in 2011)**

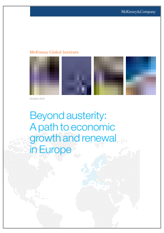
Latin America could triple GDP by 2025 if it boosts weak productivity growth and improves the management of its cities. Urban centers have been powerful growth drivers, but that contribution could be at risk because many large cities have run into diseconomies of scale. Using MGI's new Urban Performance Index (UPI), urban managers can target reform and learn from others' best practice.


**Growth and renewal in the United States: Retooling America's economic engine (February 2011)**

In order to drive growth and competitiveness, the United States needs to boost labor productivity growth to a rate not seen since the 1960s. It is important that the United States returns to the more broadly based productivity growth of the 1990s when strong demand and a shift to products with a higher value per unit helped to create jobs even as productivity was growing.


**Farewell to cheap capital? The implications of long-term shifts in global investment and saving (December 2010)**

The bursting of the global credit bubble followed three decades in which capital became progressively cheaper. MGI analysis suggests that the long-term trends in low interest rates will reverse in the decades ahead. The world may be entering a new era in which the desire to invest exceeds the willingness to save, pushing real interest rates up.




**Beyond austerity: A path to economic growth and renewal in Europe (October 2010)**

With multiple pressures on growth and constrained public finances, Europe needs structural reform even to match past GDP growth rates. Parts of Europe have begun to reform with demonstrable success. If the rest of Europe emulated their best practice, the region could add 4 to 11 percent to per capita GDP, without cutting holidays and leave.

www.mckinsey.com/mgi

eBook versions of selected MGI reports are available on MGI's Web site, on Amazon's Kindle bookstore, and on Apple's iBookstore.

Download and listen to MGI podcasts on iTunes or at www.mckinsey.com/mgi/publications/

McKinsey Global Institute
March 2011

www.mckinsey.com/mgi