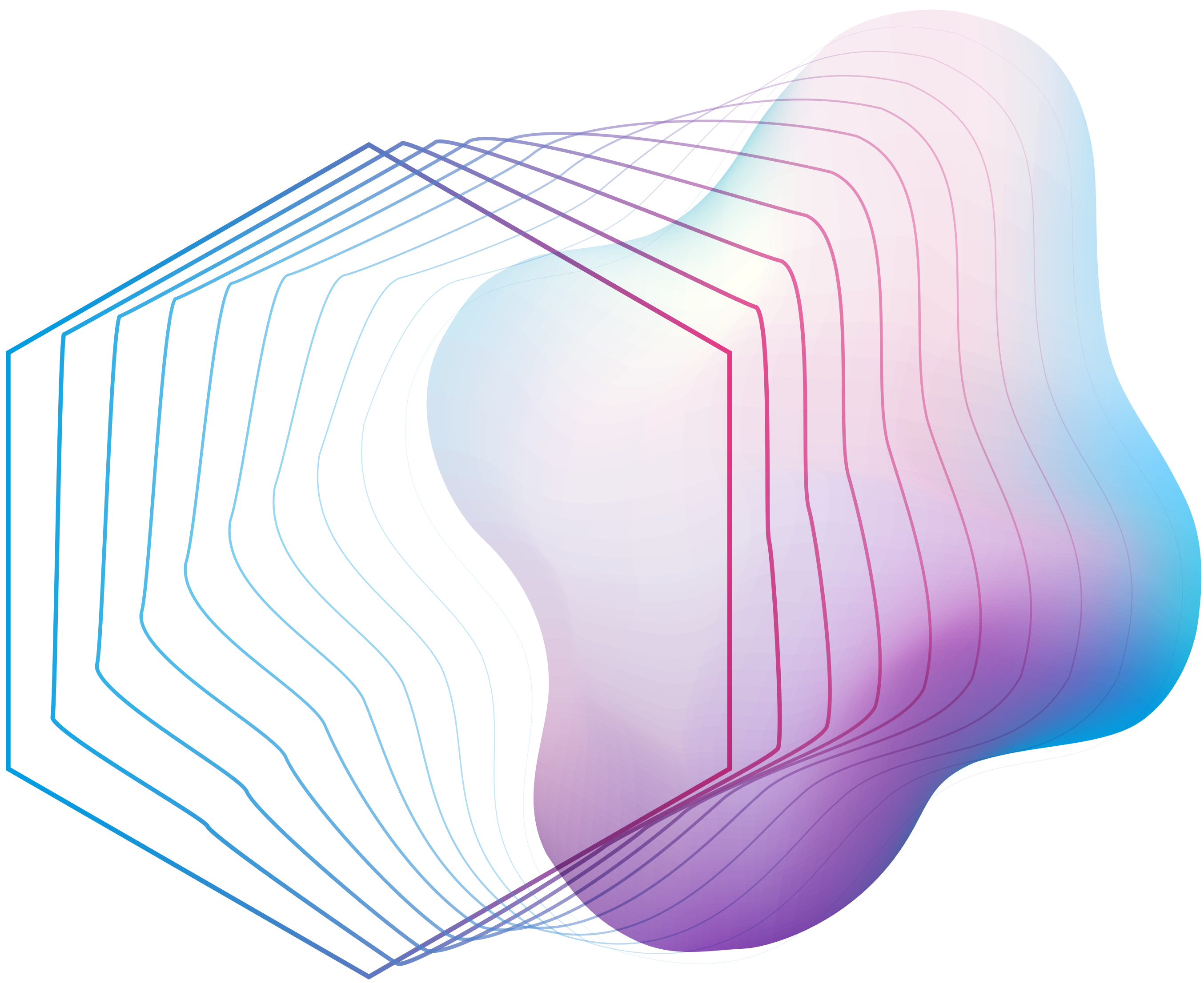
The State of Financial Services

THE NEW MONETARY ORDER

Asia Perspectives



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Dear Reader,

The monetary policy context for the global financial system since the GFC has been low or ultralow interest rates in most of the world, an expansion of central bank balance sheets, and a significant program of regulatory reform.

This period has reshaped the financial system in profound ways, in terms of liquidity and funding structures, capitalisation, the level of interest rate risk in the system, and the growth of different forms of credit.

The period has also seen significant shifts in the roles of constituents in finance, with the growth of non-bank financial institutions, the rise of regional and domestic banks in some parts of the world, and the increasing challenges with cross-border and international banking.

Yet what does the future hold?

Whether or not you believe we have moved into a longer period of inflation taming, high interest rates and lower liquidity, it is clear that low-for-long is over and this represents a major paradigm shift which will undoubtedly also reshape the financial system in the coming years. Do we understand the possible scenarios before us? Do we retain the expertise in the industry to manage through these scenarios after two decades of low-for-long? Who will the winners and losers be?

In our State of Financial Services work this year on the New Monetary Order, we explore these questions. Our work will look at the dynamics of different regions and segments in a series of papers and conclude with our global perspectives. Here is our Asia Perspectives paper on the New Monetary Order. We hope you enjoy the research.

Sincerely,

Ted Moynihan
Managing Partner and Global Head of Financial Services

EXECUTIVE SUMMARY

The global financial landscape is in the midst of a seismic transformation. A nearly 15-year period of ultralow interest rates, known as "Low for Long," is giving way to a "New Monetary Order" marked by rising rates and, in some regions, stubborn inflation.

This report examines the ways Asia's future financial landscape might be reshaped. We see four distinct scenarios unfolding, each with its own set of implications: Local banks triumph as global banks pivot; non-banks ascend in the region; Asia remains highly global, with the US dollar and global capital remaining crucial; or a supercharged Asian bloc takes shape.

What will a New Monetary Order look like in Asia?

The Asia experience of Low for Long was different from that of the United States and Europe. The effect was more nuanced, and it did not produce the paradigm shift observed elsewhere. The same is true of the region's recent rate hike and inflation experience.

However, there are still knock-on effects for Asia, given global financial and economic linkages. Domestic champion (tier 1) banks in each country have further expanded their dominant positions. Their balance sheet and funding structures are largely unchanged, and they have not needed to materially shift their strategy. Foreign banks and neo-challenger banks are still trying to chip away, with varying degrees of success. They have the capabilities to gain a share but need a differentiated strategy.

The role of the Japanese financial institutions in terms of providing external financing to the region or making direct acquisitions, especially in the Association of Southeast Asian Nations (ASEAN), has flown under the radar and is one to study for foreign players looking to make inroads. Japan's slow reversal of its zero-interest-rate policy means the country's financial institutions and intraregional capital flow will remain a strong influence on how the New Monetary Order plays out in Asia.

Non-bank financial institutions (NBFIs) are slowly growing their market share, but from a low base. There is ample opportunity to expand into underserved segments. Foreign banks could also reposition to focus on NBFI opportunities where they have significant experience. Legacy domestic banks will need to stay alert to the challenges and find ways to participate in any material NBFI opportunities.

The tension between globalization and regionalization will grow in Asia as part of a New Monetary Order. Higher interest rates or tighter regulation in the rest of the world could trigger capital outflows from the region or spur global banks to refocus strategies on their home markets.

In their place, Japanese capital and regional financial institutions would play a more dominant role. Chinese financial institutions will also grow in regional importance.

Finally, the rise of a multipolar currency region including the USD is increasingly likely, especially in ASEAN given tight linkages and maturing intra-regional payments infrastructure. The RMB will play a leading role in this shift, as the country is now the biggest trading partner for most Asian countries. Higher Chinese capital outflows, if Chinese policy settings allow, would only accelerate the RMB's regional rise. Together, these shifts will boost Hong Kong's role as a global RMB hub and as China's valve for managing the currency's internationalization.

This report evaluates diverse scenarios shaping Asia's future financial landscape. In short, our findings unveil the region's potential path along a single or combination of these scenarios: ever-dominant local banks, non-bank challengers in the mainstream, a highly globalized Asia, and a supercharged Asian financial bloc.

How will this play out across financial institutions?

For financial services firms, there will be winners, losers, and wildcards no matter which outcome prevails.

Winners across all scenarios. Domestic champion banks already have a dominant position, but there is limited room to grow in their home markets alone. In a more regionalized market with competition from NBFIs increasing, domestic champions must consider expanding their regional footprint via partnerships or venturing with NBFIs and global banks to capture new niche lending opportunities.

Losers across all scenarios. Local tier 2 banks need to adapt to survive, or they risk being acquired by local or regional competitors. Harnessing analytics and designing new products targeted to core client segments can strengthen customer relationships to defend market share.

Wildcards across all scenarios. Global foreign banks stand to benefit from any shifts between greater globalization and regionalization. In the former, they can continue with business as usual or double down on existing strategies. The latter will create a different set of opportunities, and they can focus on areas such as exploring broader regional partnerships or refocusing strategies on niche capital market lending opportunities.

Asia's financial journey through the New Monetary Order is still to be determined. Financial sector participants should keep an eye on factors such as policy rate differentials, regulatory trends, and geopolitical tensions that will influence Asia's future course.

ASIA'S POST-GFC FINANCIAL JOURNEY

And the New Monetary and Financial Order

The rules of the game for the global financial sector shifted strongly last year when the Low for Long era of monetary policy slammed shut and the New Monetary Order began.

We define Low for Long as the post-global financial crisis (GFC) period running from 2008 to the end of 2021, characterized by stimulative monetary policy and low interest rates globally, particularly in the United States and Europe. The New Monetary Order is the period from 2022 to the present, characterized by a turn in central bank actions globally and changes in macroeconomic and structural conditions in response to the reemergence of inflation in most markets.

Successful strategies in the financial sector must reflect the paradigm shift triggered by this transformation. We start by investigating how events during the Low for Long period and its more recent end have shaped Asia's monetary and financial landscape.

A quick review of events in the United States is helpful to understand the background against which the conditions for a New Monetary Order arrived in Asia, especially given historical linkages between monetary policy in the US and Asia, and global capital flows. During Low for Long, the US Federal Reserve (US Fed) cut rates to near zero and embarked on a policy of quantitative easing (QE). This created an environment of low interest rates and abundant liquidity, resulting in major shifts in risk pricing and in the relative attractiveness of investments. Super-low rates in the United States and Europe also threatened to trigger large, destabilizing capital inflows to Asia.

Meanwhile, the tightening of financial sector regulation reduced banks' profitability and changed their risk-taking incentives. Low rates lured some banks into accepting interest rate risk on high-quality, longer term securities. Non-bank financial institutions (NBFIs) expanded their lending to select sectors, including high-yield bonds, leveraged loans, and other private credit. US NBFI lending deviated from that of Asia across maturity, scale, and business models, with non-banks providing up to 68% of non financial sector credit, compared with 27% in Asia.

Asia exited Low for Long with few monetary distortions

The end of the Low for Long period resulted in fewer monetary imbalances in Asia than in the United States. Asia's central banks, in general, did not cut rates to near zero or massively expand central bank balance sheets like the US Fed did after the GFC, as illustrated by Exhibit 1 and Exhibit 2. (Japan is the clear exception, given its 20-year zero-rate policy, as we explore further in this report.) Asia's central banks also have hiked at only half the pace of the US Fed since the beginning of 2022, because inflation has consistently trended two to five percentage points lower.

Exhibit 1: Trends across inancial system drivers — Asia vs. US

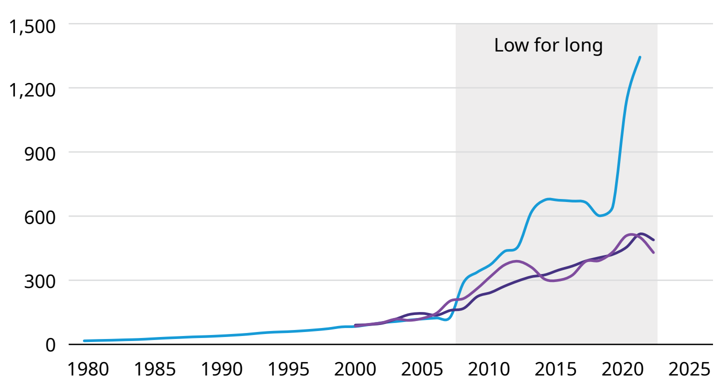
2007 Q4–2021 Q4[1]

		Monetary policy		Economic growth
		% of quarters with policy rates less than or equal to 0.5%	Central bank's balance sheet expansion	Real GDP growth CAGR
Asia				
Emerging economies	Thailand	10	2.7x	2.3
	Malaysia	0	1.0x	3.9
	Indonesia	0	2.8x	4.8
	Vietnam	0	N/A[2]	5.9
	Philippines	0	3.2x	4.6
	China	0	2.7x	7.6
Advanced economies	Japan	95	6.3x	0.2
	Singapore	72	3.1x	4.0
	Hong Kong	55	3.2x	2.0
	South Korea	7	1.5x	2.9
US				
	United States	71	9.9x	1.6

1. End of Year figures
2. Vietnam CentralBank assets data not available from 2007
Source: IMF, CEIC Data Company Ltd, Federal Reserve, Oxford Economics, Oliver Wyman analysis (July 2023)

Exhibit 2: Time series of central bank assets — Asia vs. US

Median of 10 Asian economies vs United States, Central bank assets indexed to 2001, 1980–2022



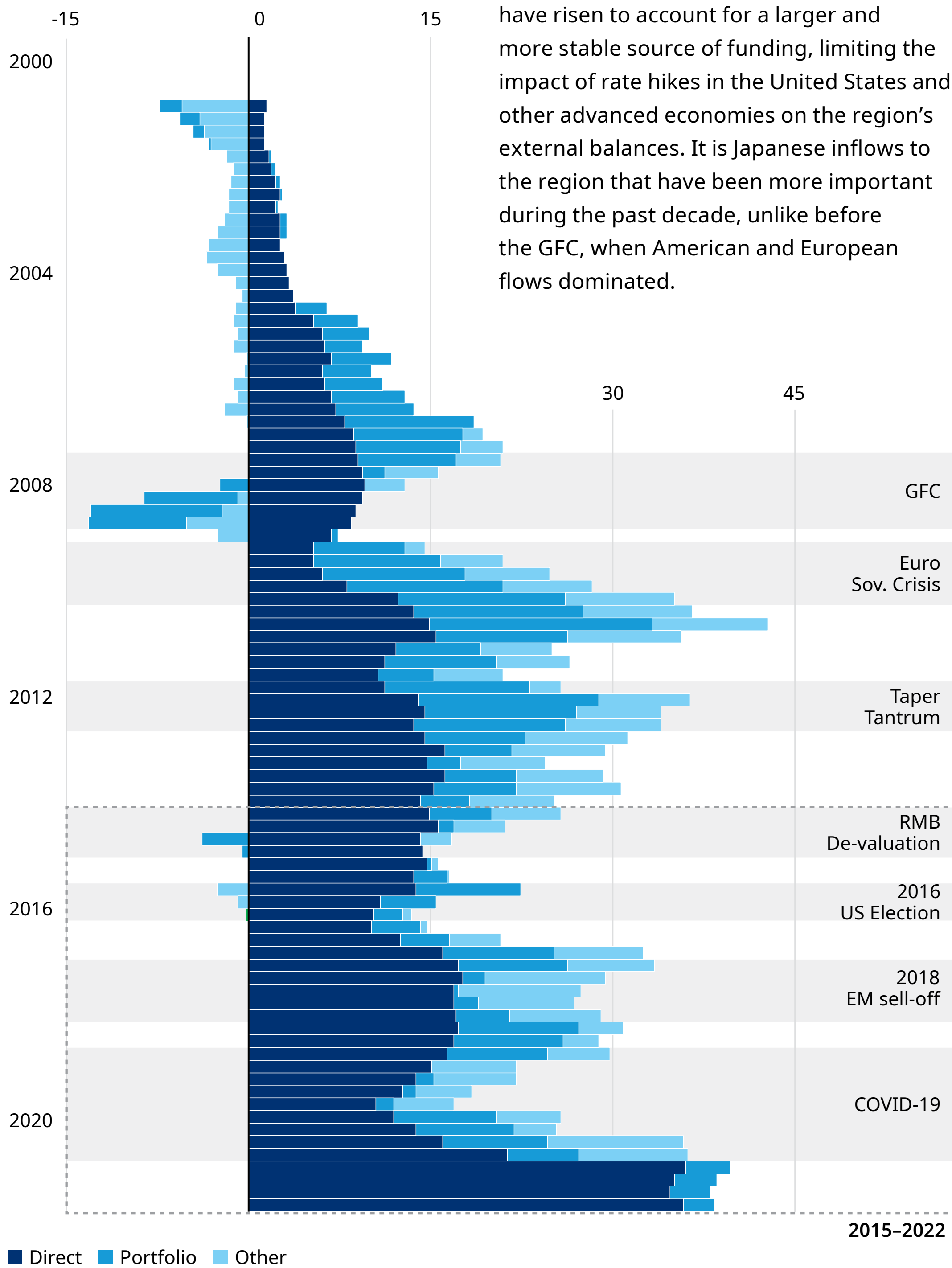
CAGR 2001–2007		CAGR 2008–2022[1]
US		
5.1%	→ **+7.2 pts** →	12.3%
Advanced Asia		
12.8%	→ **-6.7 pts** →	6.1%
Emerging Asia		
11.2%	→ **-4.5 pts** →	6.7%

Central bank assets in **Advanced Asia** and **Emerging Asia** develop in line with economy growth, while being expanded massively in the **US**

1. CAGR for US for 2008–2021, as 2022 Central Bank assets data not available
Source: IMF, FRED, OECD, Oliver Wyman analysis

Exhibit 3: Capital flows and foreign bank debts across 5 Southeast Asia (SEA) nations (Indonesia, Malaysia, Philippines, Thailand, Vietnam)

Quarterly[1], 2001–2021[2], US$ billion



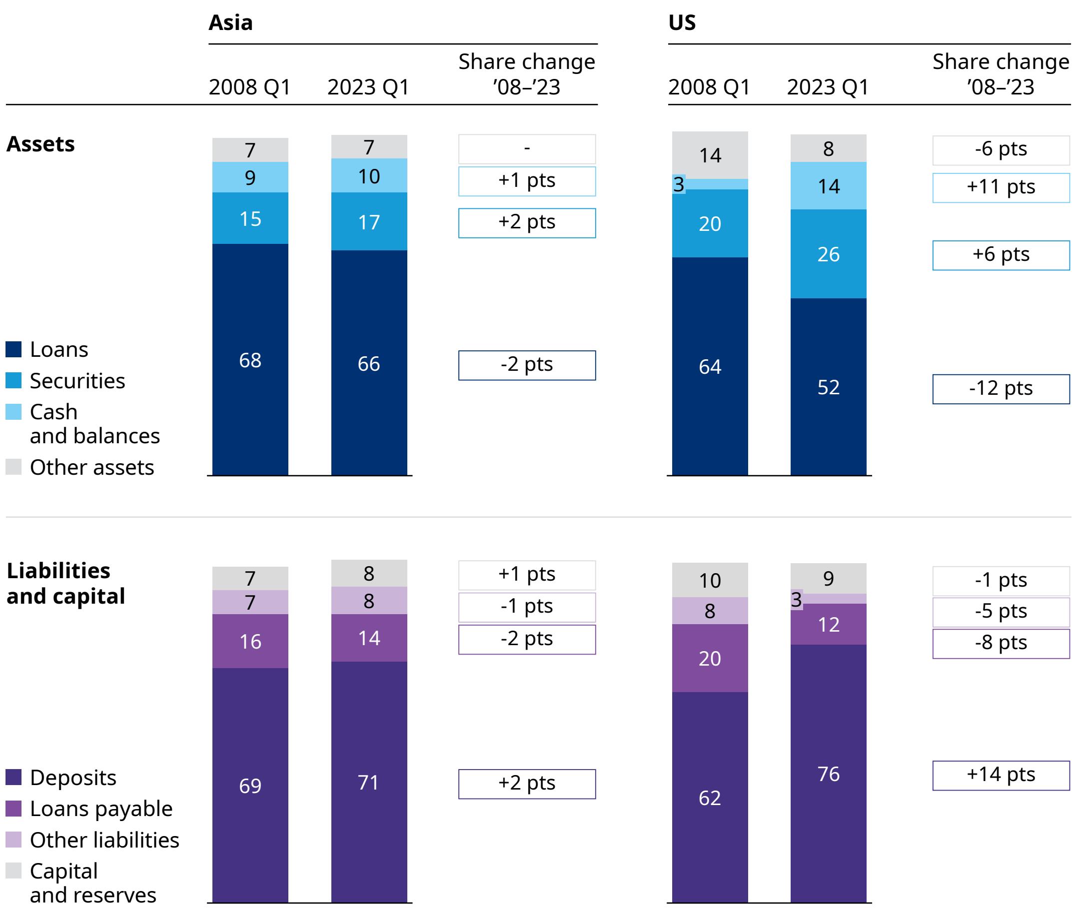
1. Smoothened by taking moving averages of four-quarter-sums
2. Vietnam data available from 2006-2021 only
Source: IMF, Oliver Wyman analysis

Neither has Asia experienced a sudden or material outflow of capital in response to recent rate rises, as QE-triggered portfolio inflows had already faded by 2015. In their place, foreign direct investment inflows have risen to account for a larger and more stable source of funding, limiting the impact of rate hikes in the United States and other advanced economies on the region's external balances. It is Japanese inflows to the region that have been more important during the past decade, unlike before the GFC, when American and European flows dominated.

Asia's financial sector balance sheets have similarly exhibited less change relative to the United States. For the leading local and regional banks, most continue to show a heavy reliance on deposits and limited exposure to high yielding securities. The sector also looks robustly capitalized, with tier 1 capital ratios having risen steadily to a median of 15.5%. There are pockets of credit risk, especially after the region's total debt levels rose a median 29 percentage points in the wake of the pandemic. But the financial sector is still relatively risk-averse following the 1998 Asian financial crisis and 2008 GFC. (Exhibit 4 and Exhibit 5)

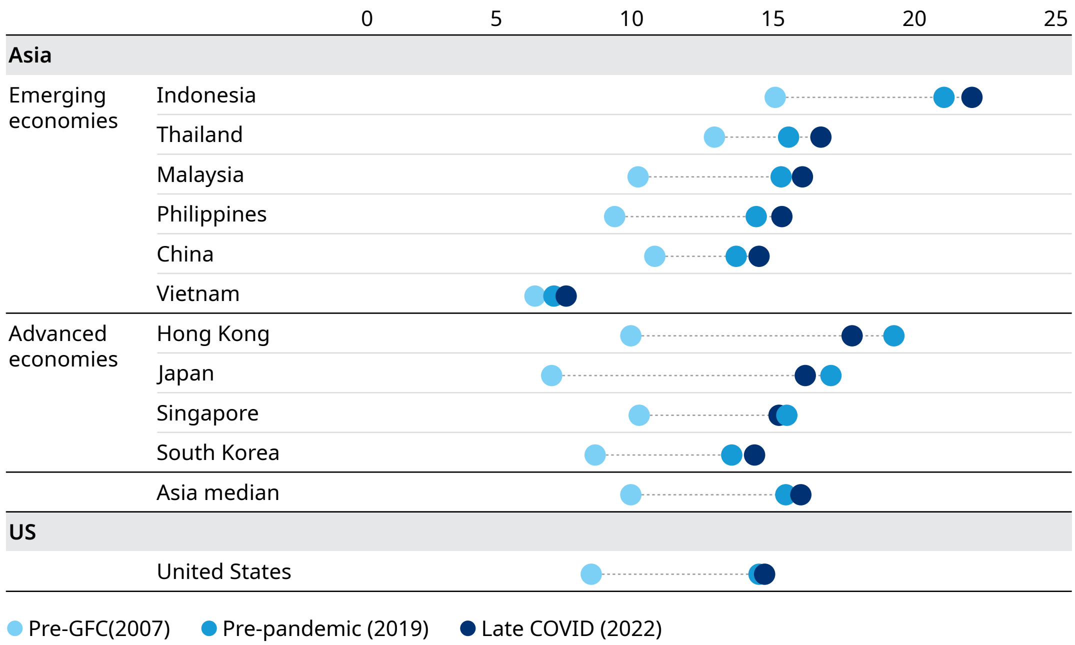
Exhibit 4: Bank assets and liabilities — Asia vs. US

% of total



Source: Oxford Economics (July 2023), Oliver Wyman analysis

Exhibit 5: Tier 1 capital ratios by market



Source: Bank of International Settlement (BIS), IMF, Oliver Wyman analysis

What comes next is far less certain. We believe financial institution competition and global and regional integration are the two key drivers of the outlook.

Asia's banks are generally in a strong competitive position, accounting for 73% of private credit. Leading local banks are in a particularly healthy position given captive deposit bases and strong corporate loan books. Our data shows that the top five banks across the region generally account for 70% to 80% of total deposits, with market concentration especially high in Singapore, Hong Kong, Japan, and Indonesia. Local banks might even face reduced international competition if global banks allocate more money to their own domestic markets, where interest rates have moved rapidly higher.

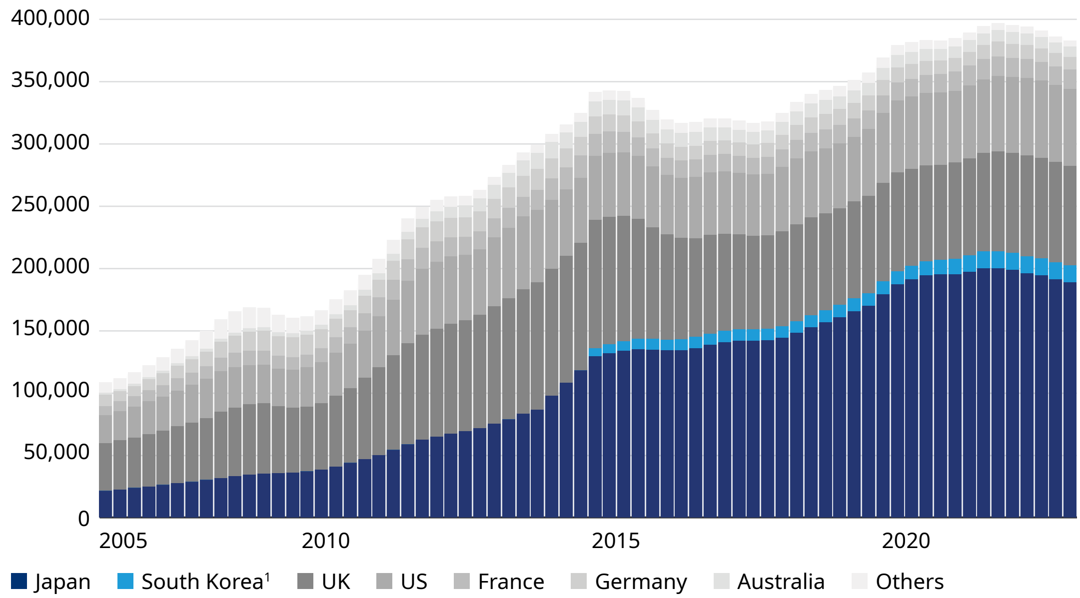
But competition is heating up. NBFIs have increased their share of private credit to 27% from 20% since the GFC, as the region's capital and financial markets mature.

Households could grow wary of receiving low yields on their bank deposits and search for alternatives, such as higher-yielding bond funds, especially if living costs spike. Bank deposits in some markets are indeed already leveling off, even as mutual funds and private equity, among others, grow in importance.

The region's economic and financial integration, meanwhile, is accelerating. Japan has played an outsized role in intraregional capital flows, with its share of foreign bank claims on members of the ASEAN soaring as Japanese firms invest in manufacturing, acquire stakes in local banks, and buy real estate. China may also come to play a greater role. It's financial transactions with the region are already rising, whether because of ASEAN's growing reliance on trade with China (which has doubled to 20% of total trade since the GFC), increased Panda bond issuance, or private capital outflows as growth and policy rates fall at home. (Exhibit 6 and Exhibit 7)

Exhibit 6: Bank claims (loans) owed by residents of 5 SEA nations to foreign banks, by lender's nationality

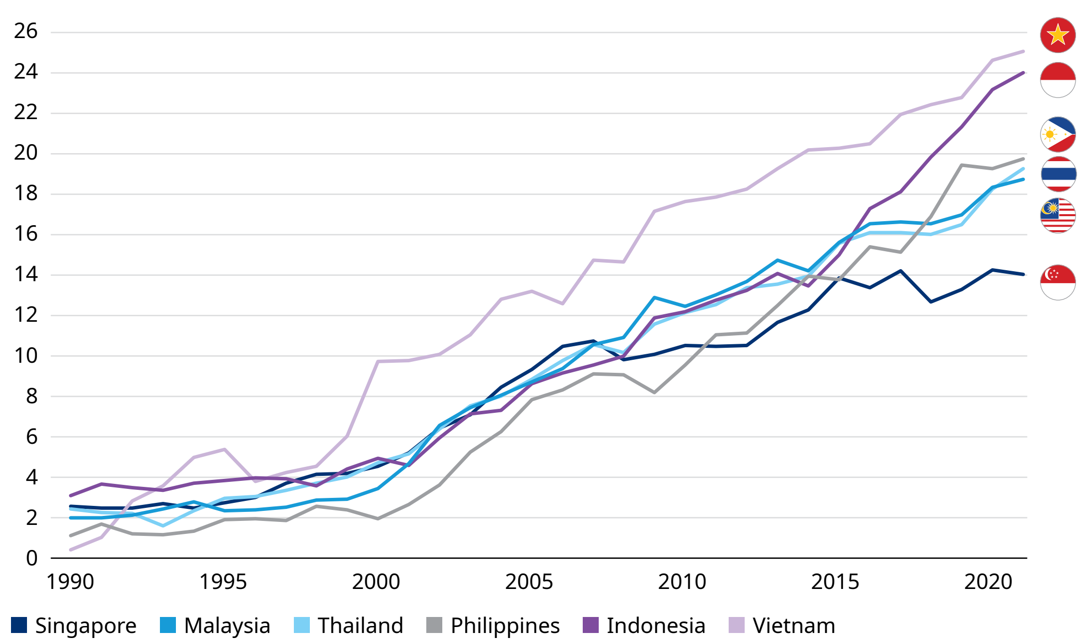
USD billion, quarterly 2005Q4–2022Q4, average of past 4 quarters



1. South Korea investment data only available from 2013Q4
Note: Does not account for foreign bank capital investment in local entities
Source: IMF, Oliver Wyman analysis

Exhibit 7: China's rise in dominance in SEA trade

1990–2021, percentage of total imports and exports



1. Share of total disclosed imports and exports
Source: IMF, Oliver Wyman analysis

If integration accelerates, local financial players might operate in a more self-contained regional ecosystem in which local banks dominate, capital and other financial flows are increasingly intraregional, and the logic and infrastructure for settling in non-US dollar currencies grows. It is still early days, but the pace of acceleration might even quicken if tighter regulation and higher interest rates in the rest of the world, in response to a New Monetary Order, deter global capital participation in Asia.

In short, we expect that the New Monetary Order will look very different in Asia compared with the United States and the rest of the world. Our analysis suggests the New Monetary Order in Asia will have two main markers. First, there will be **increased competition** between a wide range of financial institutions, including banks and non-banks, as well as local and global banks. The region's leading banks exited Low for Long in a relatively strong position, monetary policy distortions were limited, and changing interest rate differentials will shape how global institutions view Asia as an opportunity. Second, there will be **increased integration** as intraregional capital and trade flows continue to rise and the possibility of multicurrency settlement grows. Integration has already accelerated over the past 10 years and local market and regional dynamics as well as geopolitics will likely sustain and even accelerate the change.

DEEP DIVE

Asia's Many Monetary and Financial Systems

In the opening analysis, we have focused on regional trends. Despite this, we acknowledge that Asia has various distinctive monetary and financial systems, each with unique responses to the events of the past 15 years. In this deep dive, we highlight some of the more important themes.

Japan's zero rate policy and (possible) exit
Japan is the world's Low for Long pioneer, having embarked on a zero-interest-rate policy and QE well before the GFC as part of efforts to fight deflation and jumpstart economic growth. The Bank of Japan (BOJ) cut rates to zero in 1999 and largely persisted throughout the global Low for Long period. In December 2022, the BOJ announced a relaxation of the bank's yield control policy. However, the central bank is expected to take a cautious approach going forward to prevent a reversal in growth and inflation expectations.

This policy stance is important because it contributes to the shift in the region's funding. European banks pulled back from the region after the GFC even as Japanese banks increased their lending. The likelihood that Japan's current approach to monetary policy will continue suggests it will remain a source of funds for the region and a potential buyer of regional banks and asset managers — accelerating Asia's financial integration, especially between North Asia and ASEAN, as we outline in Scenario 4.

China's independent monetary and growth cycles

China is not immune to global crises, especially when they impact the country's export sector. China responded to the GFC via a massive fiscal stimulus program in 2009 worth 600 billion US dollars, or 11% of gross domestic product (GDP), as well as rapid credit expansion, including a surge in local government financial vehicles. By early 2010, the People's Bank of China (PBOC) was already tightening its monetary policy to control inflation as GDP growth reached 12%.

However, the country's capital controls and large domestic market enable the PBOC to run a more independent monetary policy relative to other countries in the region. During the Low for Long period, interest rates generally moved in response domestic conditions, rather than global ones. The same was true during the pandemic, when China's economy significantly outperformed the rest of the region and rates held steady after initial cuts.

China's exit from COVID-19 has created challenges, however. After an initial post-lockdown bounce, activity has slowed markedly as exports and real estate — both growth engines — have contracted, while consumer sentiment remains fragile. Private sector investment is also soft, with a dim outlook. The PBOC has in turn cut interest rates even as other nations hike, with inflation remaining modest and the economy flirting with deflation.

The switch in interest rate differentials with the United States could accelerate capital outflow into the rest of Asia as companies see greater opportunity abroad. Bloomberg data shows a rise in foreign corporates seeking to raise capital in the domestic market via Panda bonds, with issuance reaching a record renminbi (RMB) 14.5 billion in the first eight months of 2023, as well as capital outflows anecdotally to the Hong Kong SAR and Singapore in particular.

Hong Kong SAR follows the Fed

The Hong Kong SAR's monetary policy and financial sector activity shared greater similarities with the United States during Low for Long, owing to the city's currency peg with the US dollar. Policy rates were less than 0.5% for nearly half of the Low for Long period and 300 basis points below the Asian median. In response, and like US banks, the Hong Kong SAR's banks increased their security holdings to 39% of total assets from 17% between 2008 and 2022, raising the sector's exposure to interest rate risk.

The challenge for the Hong Kong SAR from a monetary policy perspective is navigating between tightening US policy and slowing growth in China. Inflation peaked at between 2–3% even as interest rates rose. Real interest rates have since approached record highs at near 3.0%, levels not seen since the deflationary period after the Asian crisis. With China's economy slowing, the Hong Kong SAR will need to navigate an environment of historically slower growth matched with historically high real interest rates.

Singapore and its exchange rate regime

Much like Hong Kong, Singapore's monetary policy shared similarities to that of the United States during Low for Long. The country's exchange rate targeting and open capital account mean the Monetary Authority of Singapore (MAS) largely gives up control over domestic interest rates, and policy rates moved near lockstep with those in the United States after the GFC and during the recent hike. In contrast to Hong Kong, however, banks did not increase their holdings of securities significantly, instead seeing a shift of assets into cash balances.

Singapore has also benefited from significant Foreign Direct Investment (FDI) and other capital inflows, partly owing to the country's status as both an international and an ASEAN financial hub. Inflows have risen steadily since the GFC and throughout the pandemic. Japanese financial institutions play an important role. But events across the rest of the North Asia have also contributed to a rise in inflows as investors seek to rebalance portfolios, not least against rising geopolitical risks.

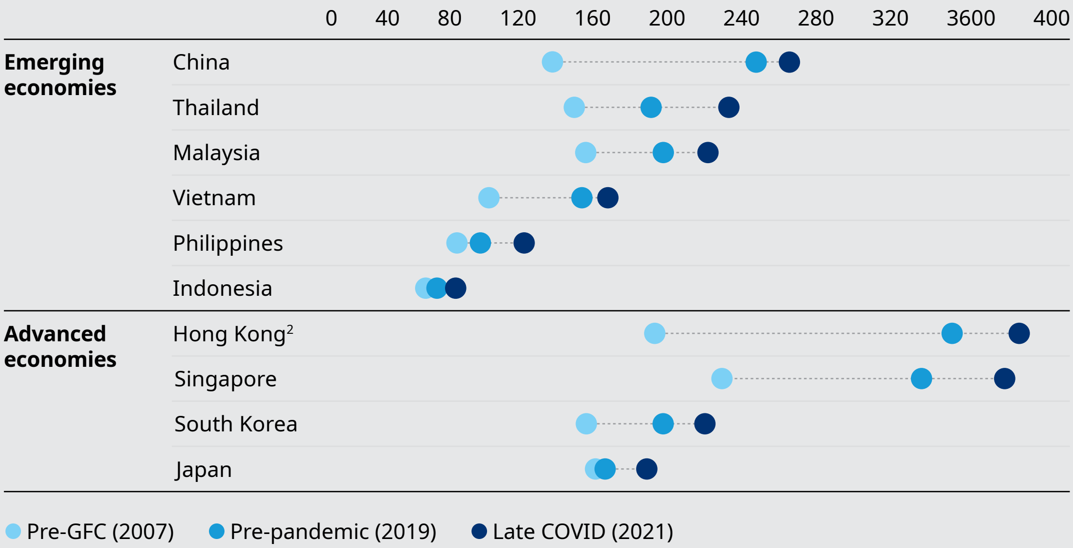
Thailand's debt challenges and security holdings

Thailand's divergence from the regional trend was more felt via balance sheets, rather than interest rates as the country's banks grew their securities assets faster than loans, with the former's share rising to 20% from 12% between 2008 and 2022. Local government bonds account for a significant share of those holdings. But banks were also buying corporate bonds, and total corporate debt growth outpaced bank loan growth during the period.

Thailand's debt challenges, which emerged in 2015, also worsened during the pandemic. The country's total private and public debt as a percentage of GDP has increased by 42 percentage points to 232%, the largest increase among ASEAN member nations. GDP growth has also lagged, similar to Hong Kong, creating greater risks in the current credit cycle. Managing these risks among financial sector players will be key going forward.

Exhibit 8: Total debt snapshots across pre-GFC, pre-pandemic, and late COVID

Total private[1] and government debt as a % of nominal GDP in key Asian economies



1. Includes household and non-financial corporations debt
2. 2020 numbers used for late COVID as 2021 not yet available for Hong Kong

Source: IMF, Oliver Wyman analysis

Indonesia's 15 years of strong growth

Indonesia has enjoyed a remarkable run since the GFC, the recipient of steady portfolio inflows and FDI during the period relative to the rest of the region. A sell-down of foreign holdings of government debt during the pandemic did little to disrupt balance of payments strength. The country also kept tight control of its total debt levels, which rose only 15 percentage points to 81% by 2021 based on International Monetary Fund data. The banking sector's balance sheet was largely unchanged during the period, with deposit and loans accounting for the large share of either side of the ledger.

The rise of the non-bank share of total credit relative to the rest of the region is worth noting, with the figure rising six percentage points to 18% between 2008 and 2022. The opportunities for financial infrastructure and technology (FITs) players as incumbents to capture a share of the underbanked small and medium-sized enterprises (SME) and consumer loan markets via new digital solutions remains compelling in a market of nearly 280 million people.

Indonesia has many large tech players and an even greater number of challengers. Regulators will want to continue keeping a close eye on balancing innovative business models with structural risks as the space continues to evolve through new entries and consolidation activity.

LOOKING AHEAD

Scenario Analysis

Asia's economic and financial landscape has evolved since the Low for Long period. Rising interest rates in the New Monetary Order will inevitably affect financing and liquidity conditions — but there are no signs yet that the impact will be significantly greater than a typical credit cycle for most countries. Meanwhile, the region's GDP growth continues to outpace that of the United States and Europe, even as the regionalization trend — from capital to trade flows — continues.

This paper steers clear of crystal ball predictions. Instead, we present a spectrum of possible outcomes, forming the foundation for structured discussions. Through careful analysis, we embark on an exploration of various scenarios that could shape the future of the financial landscape.

Scenario drivers and potential outcomes

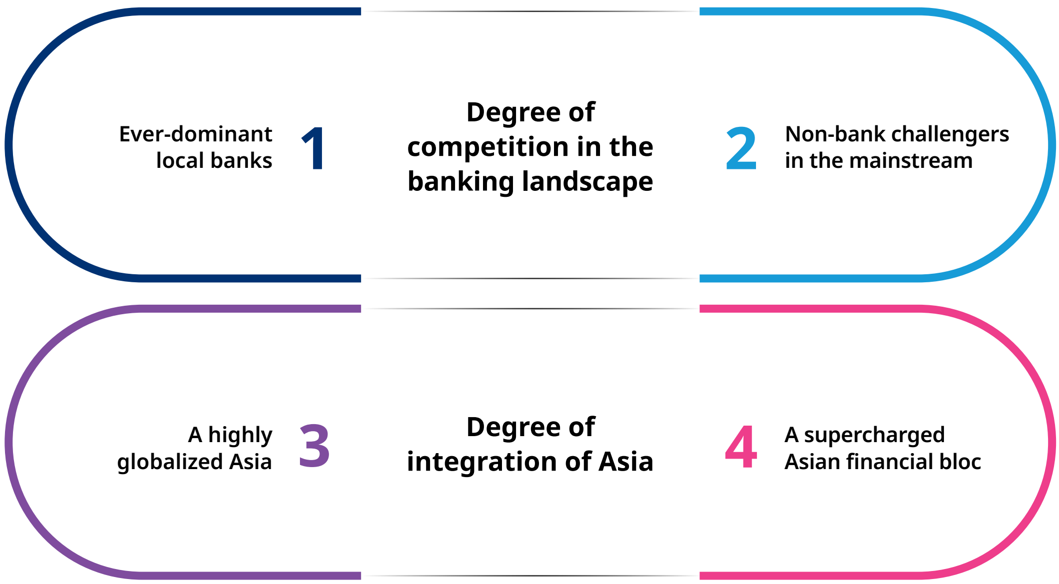
Central to our analysis are two pivotal scenario drivers that have gained prominence in the transition to the New Monetary Order and have the potential to mold the evolution of Asia's financial system:

The degree of competition in the banking landscape. This is the extent to which the New Monetary Order strengthens the banks' dominant position or triggers competition. Will banks, particularly local banks, maintain their dominance, or will a surge of competition from foreign banks and non-banking entities reshape the financial landscape?

The degree of integration of Asia. In the New Monetary Order Asia could continue evolving into a highly globalized interconnected hub — or it could turn inward and focus on regionalization. Will Asia's future be intricately tied to the US dollar, or will regional integration through local currency pairs and a regional payment bloc become the defining brushstroke?

Three factors could affect these drivers, steering Asia toward one scenario or another. First, Asia's interest rate situation compared with the rest of the world will influence market attractiveness, affecting foreign capital flows. Second, the tightening or relaxation of financial regulations related to deposit and lending practices could either boost or hinder the growth of both banks and non-banks. Finally, cross-regional, long-term investment sentiment and confidence might be swayed by geopolitical tensions, adding a layer of complexity to the scenarios.

In short, the New Monetary Order signifies a phase of change in Asia's financial landscape. The intertwined drivers of competition in the banking sector and the degree of Asia's integration will play crucial roles in shaping the region's trajectory, unveiling scenarios that offer strategic foresight to financial sector players.



SCENARIO 1

Ever-dominant local banks

In this scenario, **local banks triumph and global banks pivot, particularly in the deposit space.** Interest rates in Asia stay above where they were during Low for Long; local banks increase dominance and global banks strategically recalibrate due to heightened competition in building a local deposit base and the attractive yields in home markets.

Local banks demonstrate a strong ability to retain most of their deposit base despite raising deposit rates much less than their lending rates, leading to improved net interest margins (NIM). Tier 1 local banks continue to dominate in the market, owing in part to their strong deposit base, crowding out competition from foreign banks and NBFIs. This scenario is a continued trajectory of trends that are observed across ASEAN markets today, where the top five local banks capture on average 70% to 80% of deposit share (Exhibit 9). In addition, the number of neo-challenger banks is emerging steadily across the region. They have yet to challenge the share of the dominant banks, with mainstream customers hesitant to move their primary banking relationships to new "untested" players on the block, but will continue to refine their business models and value propositions.

For global foreign banks, the US and Europe's exit from the Low for Long era into the New Monetary Order ushers in higher yields within their home markets. This reshapes the playbook for global foreign banks.

For large global foreign banks that deploy their balance sheets in Asia, a strategic recalibration unfolds as Asia's attractiveness dims amid heightened competition in building a robust local deposit base and attractive yields within their home turf. This steers them away from expanding their Asian footprint. Nevertheless, large global transaction banks continue to benefit from a fragmented banking sector among Asian countries as legacy payment mechanisms are maintained.

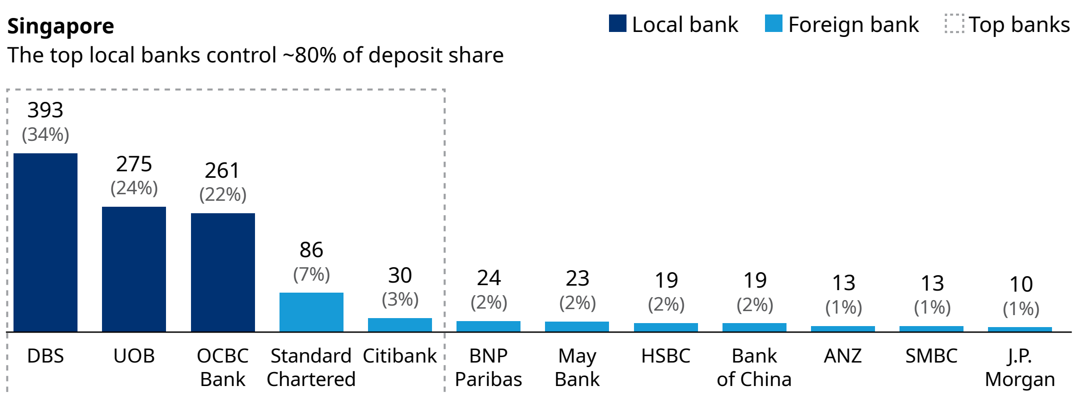
NBFIs, meanwhile, find themselves grappling with escalating funding costs in the face of rising overall interest rates and the inability to convince depositors to switch to alternative non-bank assets, such as retail bond funds. They also face increasing regulatory pressure, such as policies on strengthening oversight and addressing risks as proposed by the Financial Stability Board (FSB).

Exhibit 9: Leading banks by deposit base in each economy, categorized by domestic or foreign ownership

Deposit base in US$ billion, shares of top 12 bank in %, 2022

Singapore

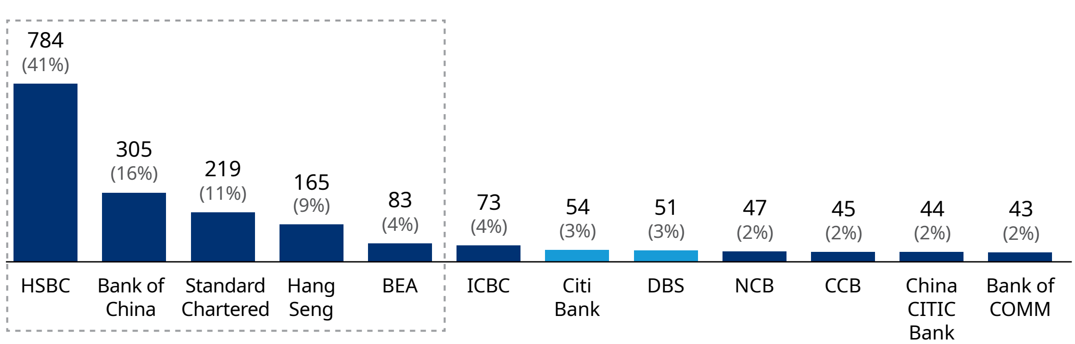
The top local banks control ~80% of deposit share



Source: S&P

Hong Kong

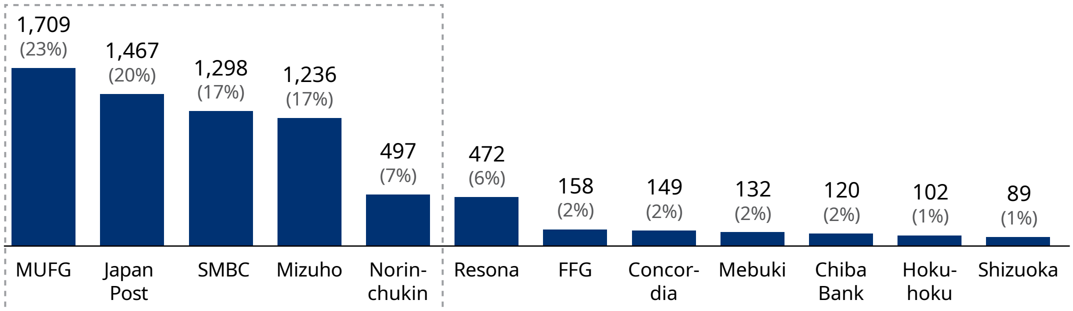
The top local banks control ~80% of deposit share



Source: S&P

Japan

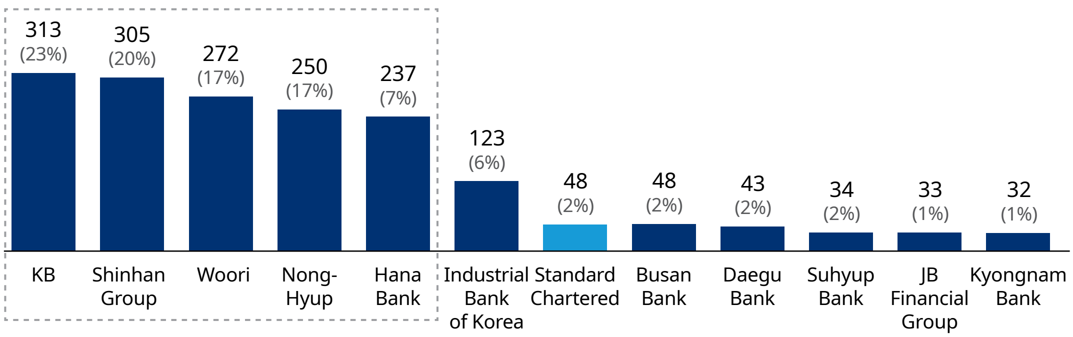
The top local banks control ~85% of deposit share



Source: S&P

South Korea

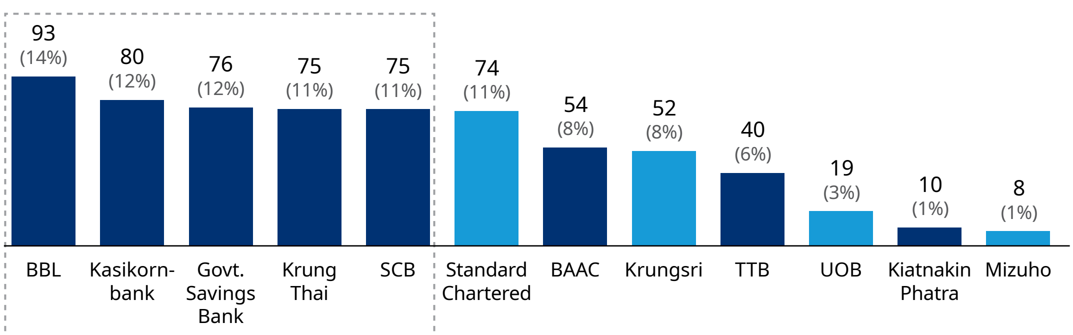
The top local banks control ~75% of deposit share



Source: S&P

Thailand

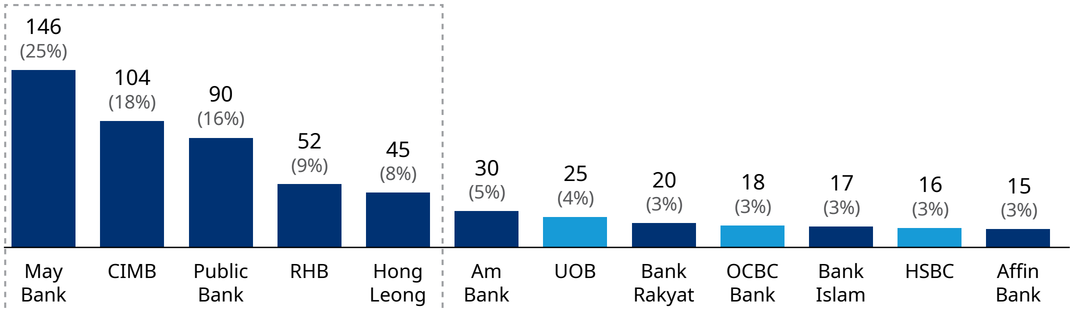
The top local banks control ~60% of deposit share



Source: S&P

Malaysia

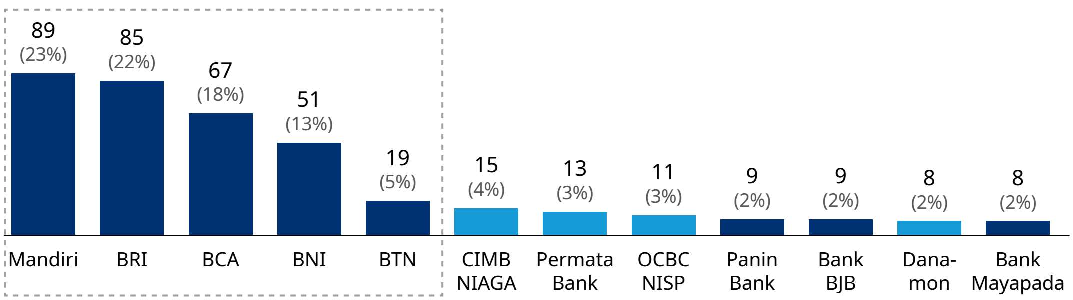
The top local banks control ~75% of deposit share



Source: S&P

Indonesia

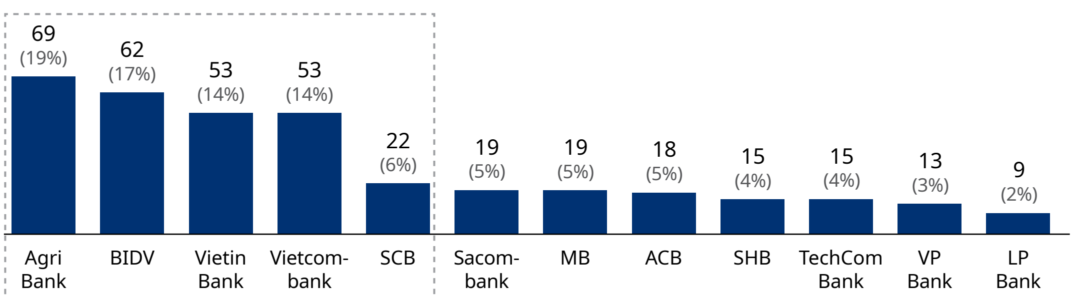
The top local banks control ~80% of deposit share



Source: S&P

Vietnam

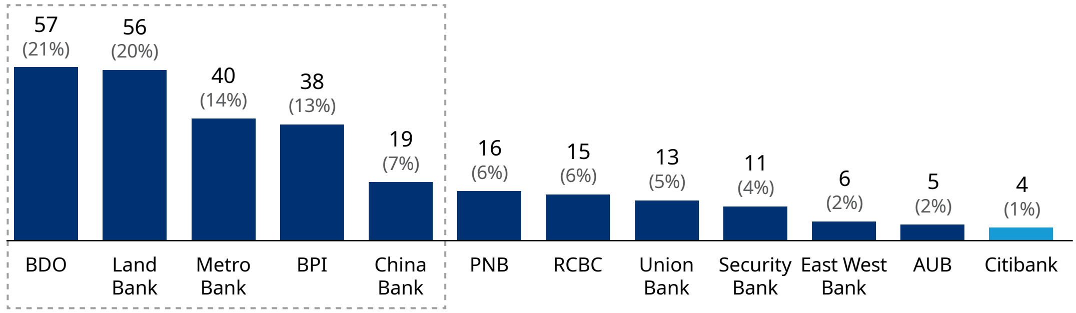
The top local banks control ~70% of deposit share[1]



1. While Japanese banks have been investing capital into Vietnamese local banks, they have only been able to acquire minority stakes, given regulations limiting the combined stake of foreign investors in a bank to 30%

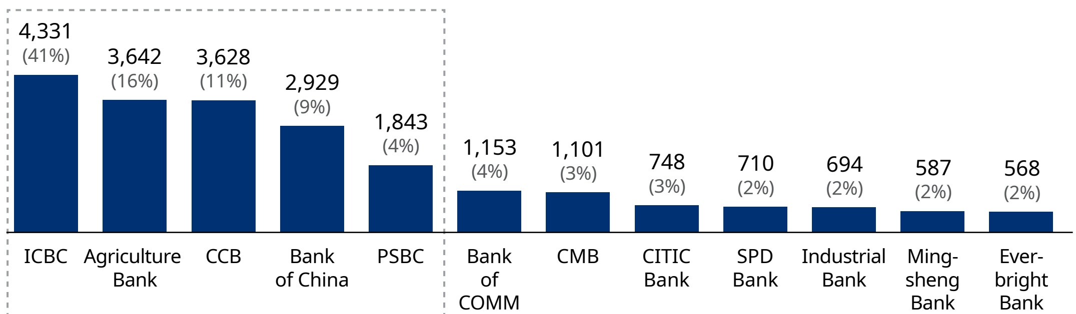
Source: S&P

Philippines
The top local banks control ~75% of deposit share



Source: S&P

China
The top local banks control ~75% of deposit share



Source: S&P

SCENARIO 2

Non-bank challengers in the mainstream

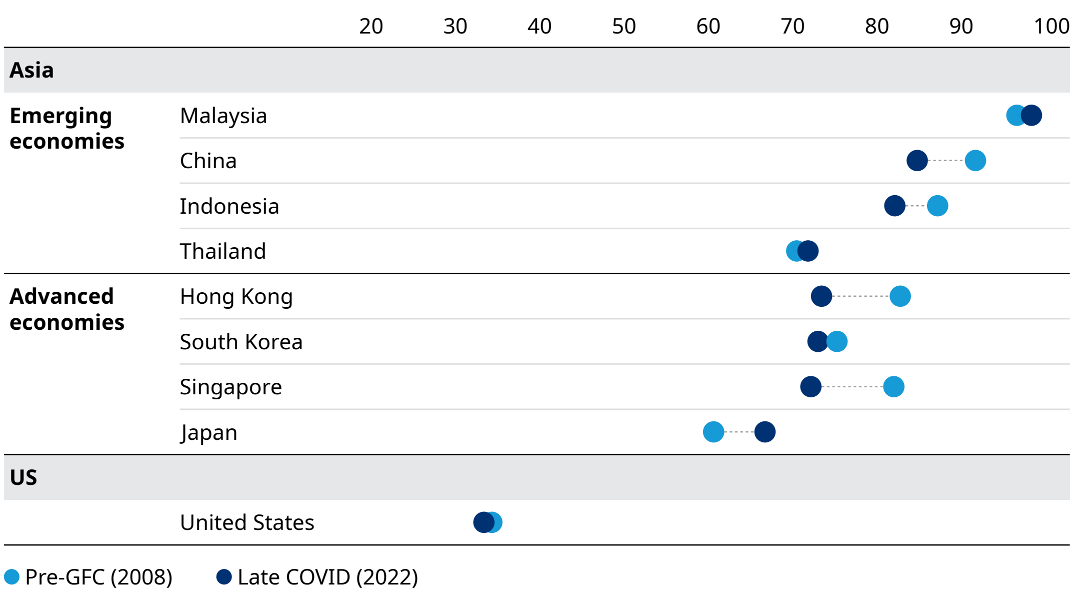
In this scenario, **non-banks grow their market share, particularly in lending.** There is conductive regulatory environment, and the non-bank financial sector matures rapidly alongside the growth of the corporate bond market as customers seek more competitive lending solutions.

Banks enjoy rising profitability fueled by lower funding costs, but both existing and unserved customer segments have increased appetite for alternative lending products. Local banks with a legacy model focused on retail or SMEs face growing competition from NBFIs in credit provision. Foreign banks with a capital market focus or an appetite to fund have an advantage as the maturing NBFI segment requires funding from capital markets as well as through bank loans.

NBFIs, particularly asset management firms and consumer finance institutions, expand their share of credit and challenge banks from a lending perspective as the non-bank industry matures from a low base. These non-banks find innovative ways to get ahead and serve a market untapped by the banks. Asset managers expand their corporate bond and other bond-like offerings (for example, retail bonds backed by private equity cash flows) to retail investors, supported by regulators seeking to preserve household wealth against rising inflation. Consumer finance institutions, funded by regional and global investors, capture niche opportunities from slower-moving local banks and find innovative ways to serve a market untapped by banks. Other non-banks such as private equity firms benefit from significant intraregional capital flows, especially from China to Singapore, allocating a growing share of assets into direct lending to higher-yielding corporates. This growth is further enabled by more supportive regulatory stances, with regulators more comfortable with NBFIs as they seek new financing channels for the private sector.

Exhibit 10: Bank share of non-financial sector credit across key economies

In % of all total private (non-financial) sector credit, Q1'00-Q4'22



Source: Bank of International Settlement (BIS), IMF, Oliver Wyman analysis

SCENARIO 3

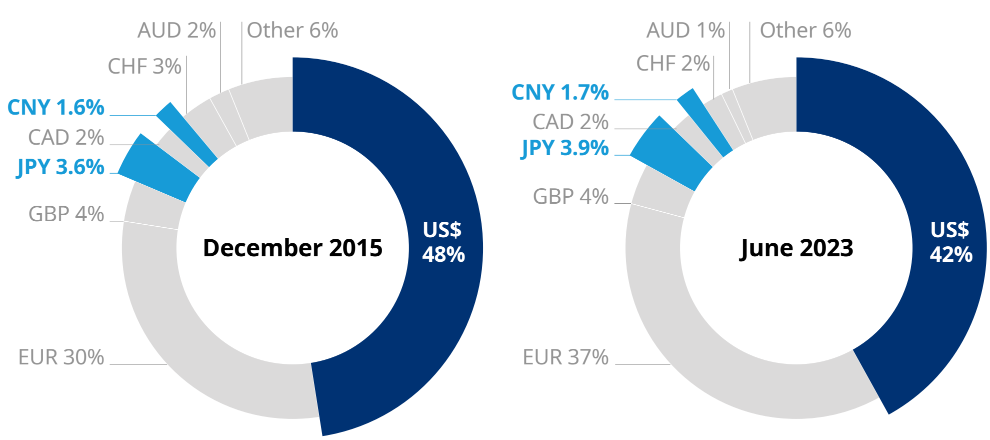
A highly globalized Asia

In this scenario, **the US dollar and global capital remain pivotal to the region.** Geopolitical tensions ease and global inflation ebbs, leading to a stream of global capital inflow to the region. Global bank activity remains robust, and the US dollar retains its primary status. Asia's global attractiveness remains high as growth rates accelerate, especially in Southeast Asia, and risk measures stabilize or ease. China returns to 5%-plus GDP growth and the government further liberalizes the financial sector, creating new opportunities for foreign investors and banks in China.

Global players find Asia increasingly attractive. Global foreign banks with substantial US dollar funding explore inorganic growth or partnerships with private financial sector players. Foreign banks focus on capital markets opportunities, where they already have a competitive edge. Global market infrastructure and payment FITs, as well as financial exchanges, benefit from the stronger capital flow between Asia and the rest of world.

The increased activity of foreign institutions in Asia creates a competitive landscape for local banks. Local state-owned banks, in particular, struggle to pivot their strategies toward higher commercial value areas due to restrictions toward government priorities. Meanwhile, the US dollar remains the primary currency for trade settlement across the region (Exhibit 11). Factors such as limited RMB capital-account convertibility, local Asia currency volatility, and intricate payment rails for non-US dollar cross-border settlements contribute to the US dollar's unwavering prominence.

Exhibit 11: Share of international payment settlements by currency[1] — global



1. Share of transactions conducted via SWIFT. At current exchange rates. Excludes international transactions within the Eurozone
Note: Percentages may not total 100 due to rounding
Source: IMF, SWIFT, Oliver Wyman analysis

SCENARIO 4

A supercharged Asian financial bloc

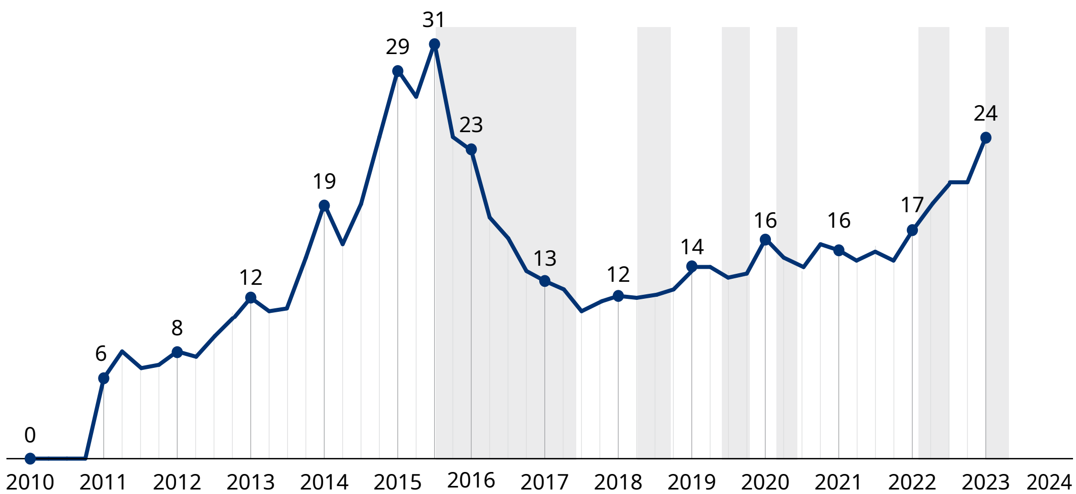
In this scenario, **a resilient Asia bloc takes shape.** Higher intraregional capital flows, increased non-US dollar settlement, and improved cross-border settlement drive a regional financial bloc. Global influences within the region are waning due to US and European interest rates remaining high, contributing to less capital flow to Asia from outside the region. Within ASEAN markets, a structural upswing is evident, along with a persistent drive to reduce supply chain risks.

Regional Asia banks play a greater role in both capital and financing. There is a shift toward North Asian and Southeast Asian banks in terms of intraregional capital flows, replacing the once-dominant Western capital presence. Noteworthy shifts include Singaporean or Malaysian banks increasingly assuming roles once held by global players in neighboring ASEAN countries. In addition, regional North Asian banks with established regional footholds are deepening their intraregional financing activities to capitalize on lucrative opportunities within ASEAN markets. This trend is exemplified by Japanese banks reallocating capital to the region, further facilitated by tighter US financial regulations that hinder expansion in the US market.

A shift toward a multipolar currency region accelerates. RMB-denominated financing emerges as a new dynamic given that China's interest rates remain low relative to local and US dollar rates. Panda-bond issuance by non-China Asian corporates surges, especially among ASEAN economies. The Hong Kong SAR expands its role as a valve for the RMB's internationalization, accelerating its development of CNH solutions and building significant CNH liquidity. A rapid rise in Asia's intraregional trade and capital flows increases demand for local currency settlement where companies are heavily exposed to a single country. The US dollar remains important, but its share of FX settlement nevertheless falls, with local Asia currencies taking its place.

The region is moving toward a multicurrency landscape hinging on the RMB. China's share of total trade with ASEAN markets continues to rise from its already high 20%, while RMB settlement rises in markets where China's pricing power is high or a Chinese entity is a counterparty to the trade. The growth of Panda-bond financing further accelerates regional corporates using RMB for settlement.

Exhibit 12: Share of RMB settlement[1] in China's cross-border goods trade
2011–2023, (%)



1. RMB share of total goods settlement over sum of total imports and exports under BoP current account
Source: CEIC, Oliver Wyman analysis

Rapid improvements in the speed and cost of cross-border settlement in local Asia currency pairs accelerate the overall shift. Project Nexus, among other initiatives, scales faster than expectations from improving the retail payment side into the corporate side.

As the shift towards a multipolar currency region gains momentum, the financial landscape is undergoing transformation. Regional, rather than global, NBFIs, financial exchanges, and capital markets stand to benefit. Amid the dynamic transformation, tier 2 local banks (family or conglomerate banks), along with global banks deploying their balance sheets in Asia and US dollar-based financiers, are likely to encounter challenges. These players need to identify new avenues for engagement and growth in this evolving landscape.

CALL TO ACTION

Each of these scenarios brings a wide spectrum of opportunities and obstacles for the various players in the financial services sector as well as policymakers and regulators.

In the table below, we consolidate the suggested actions for the financial sector players likely to be impacted.

The Clear Beneficiaries	The Moderately Benefited	The Challenged Entities
SCENARIO 1. Ever-dominant local banks, in deposits		
Large/tier 1 local banks Extend competitive advantage via sector consolidation or inorganic growth — for example, merger and acquisitions (M&A) with tier 2 banks. Solidify franchise through technology investments, such as modernizing technology infrastructure. Innovate and develop tailored product positioning by understanding depositors' behavior.	**Global transaction banks** Take advantage of continued fragmentation in banking and overall growth in the banking sector.	**Global banks deploying balance sheet** Pivot into niche business segments (such as wealth management). Enter partnerships as an alternative to head-to-head competition with local champions. **NBFIs** Target the niche segment untapped by banks, for example, micro, small, and medium enterprises (MSMEs).
SCENARIO 2. Non-bank challengers in the mainstream, in lending		
NBFIs, particularly consumer finance institutions and asset managers Stand out through innovative proposition. Explore potential sector consolidation or inorganic growth.	**Global banks with capital market focus, or appetite to fund** Leverage rise of bonds (from non-banks) and build offerings around bond issuance as a beachhead back into the market. **Market infrastructure FITs** Partner with NBFIs to develop technological infrastructure to enable new products and services. **Global private capital players and sovereign wealth funds** Maximize returns from NBFIs investments through NBFI investment.	**Small local banks with legacy models** Partner with and invest in NBFIs to offer a wider range of customer propositions and diversify revenue streams. Deepen understanding of consumer (analytics) to defend their share.

The Clear Beneficiaries	The Moderately Benefited	The Challenged Entities
SCENARIO 3. A highly globalized Asian region		
Global banks with substantial US dollar funding Leverage lower cost of funding to compete against local champions and smaller players. Explore inorganic growth opportunities.	**Global transaction and capital market-focused banks** Capitalize on strong deal flow to facilitate capital investment into the region.	**Local state-owned banks** Refine propositions to retain a competitive edge over foreign challengers. Prioritize risk management in pricing and lending.
Global market infrastructure and payment FITs Partner with banks to continue facilitating capital market activity and inter regional payment.		
Global financial exchanges Capitalize growth from continued strong capital flows in and out of Asia.		
SCENARIO 4. A supercharged Asian financial bloc		
Regional banks with established footprints (especially North Asia and Southeast Asia banks) Double down on new revenue streams via direct access to regional payment infrastructure. Embrace lessons learned from past investments to focus on drivers of differentiated success.	**Local and regional market infrastructure FITs** Prepare for increased demand for local currency pairs in cross border transactions.	**Local tier 2 banks** Develop unique propositions toward local customers through understanding depositors' behavior and deepening relationships.
Regional NBFIs Partner with banks and other FITs to deliver innovative offerings to capture a piece of the growing payment opportunity.	**Sovereign wealth funds** Capitalize on the move toward self-sourced capital.	**Global transaction banks/US dollar based financiers** Strategically pivot away from the region, or seek partnerships with winning players to have a share of a growing pie.
Regional financial exchanges Take advantage of increased intraregional flows to capture share from global players.		

Navigating Scenarios

Key Imperatives for Asia's Policymakers and Regulators

Each of the four scenarios offers a tapestry of challenges and opportunities for policymakers and regulators. The decisions invariably require a delicate consideration of costs and gains, as trade-offs abound. Within this framework, several important areas call for the attention of Asia's policymakers and regulators to take strategic action.

SCENARIO 1

Ever-dominant local banks

As the sector retains its prominence, large tier 1 local banks and global counterparts could choose the route of expansion through mergers and partnerships. It is critical for policymakers to increase focus on stability to safeguard the sector from M&A wave risks.

SCENARIO 2

Non-bank challengers in the mainstream

As non-bank entities ascend, policymakers and regulators must prioritize financial system stability to curb excessive risk-taking in pursuit of market share. Policies are needed to ensure NBFIs improve risk management practices and protect customers' interests. The rise of NBFIs also invites regulators to explore collaboration to push for a financial inclusion agenda.

SCENARIO 3

A highly globalized Asian region

Policymakers need to prioritize coordination and collaboration with other global regulators to support the growth of capital flows. As markets become increasingly integrated, regulators should also reevaluate their strategies or restrictions for the local state-owned banks to enable them to compete with global players and remain competitive.

SCENARIO 4

A supercharged Asian financial bloc

Policymakers need to invest in increasing intraregional coordination and collaboration across ASEAN and North Asia markets. This includes refining and aligning risk management practices in respective home jurisdictions, as well as coordinating efforts to develop the non-US dollar market.

Facing the Future

A grand experiment in global financial markets is playing out as central banks around the world establish a New Monetary Order that looks very different from the era that preceded it. Asia is both central to the conversation and separate from it in important ways. The competing forces of globalization and regionalization, as well as competition and integration, are already clashing; any change in geopolitical tensions could alter the balance one way or another.

In that context, the power of scenario analysis becomes apparent for financial services firms and policymakers alike. For firms, there will inevitably be winners, losers, and wildcards. Financial institutions should look for early signs of a tipping point in policy rate differentials, regulatory trends, and geopolitics and pivot accordingly. Likewise, for policymakers, the ability to assess in real time the implications of their decisions on the evolution of a new financial services landscape — and change direction when necessary — will be paramount.

Asia's financial journey through the New Monetary Order is still to be determined. But many of the forces that will shape its course are already coming into view. Now is the time for leaders to navigate.

GLOSSARY

ASEAN	The Association of Southeast Asian Nations, a political and economic union of 10 member states
BIS	Bank of International Settlements, based in Switzerland
BOJ	Bank of Japan, the central bank of Japan
Bop	Balance of payments, the statement of all transactions made between entities in one country and the rest of the world
BOT	Bank of Thailand, the central bank of Thailand
CNH	Chinese Yuan traded in the offshore market
FDI	Foreign direct investment, the ownership stake in a foreign company/project made by an investor, company or government from another country
FITs	Finance infrastructure technology companies, commonly large cross-border payment gateways
FSB	Financial Stability Board, an international body that monitors and makes recommendations about the global financial system
FX	Foreign exchange, the trading of sovereign currencies
GDP	Gross domestic product, the monetary value of final goods and services produced in a country in a given period of time
GFC	Global financial crisis, the period of extreme stress in global financial markets and banking systems between mid 2007 and early 2009
HKMA	Hong Kong Monetary Authority, one of the Hong Kong SAR’s financial regulators
HKSAR	Hong Kong Special Administrative Region, a Special Administrative Region of China
IMF	International Monetary Fund, based in the United States
MAS	Monetary Authority of Singapore, Singapore’s central bank
MSME	Micro, small, and medium-sized enterprises, businesses defined as having annual revenue or number of employees below a certain threshold. Specific definition typically varies by country
M&A	Mergers and acquisitions, consolidation of companies or their major assets through financial transactions between companies
NBFI	Non-bank financial institutions, financial institutions that offer various banking services but do not have a banking license
NIM	Net interest margin, a measure of the net interest income a financial firm generates, based on the difference between interest paid and interest received, adjusted by the total amount of interest-generating assets
Panda bonds	Chinese renminbi-denominated bond from a non-Chinese issuer, sold in the People’s Republic of China
PBOC	People’s Bank of China, the central bank of the People’s Republic of China
QE	Quantitative easing, a monetary policy action in which a central bank purchases government bonds or other financial assets to increase the domestic money supply and stimulate economic activity
SEA	Southeast Asia broadly includes Brunei, Cambodia, East Timor, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam
SMEs	Small and medium-sized Enterprises, businesses defined as having annual revenue or number of employees below a certain threshold. Specific definition typically varies by country
US Fed	The US Federal Reserve, the central banking system of the United States

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