BOC Research Institute

Global Banking Industry Outlook

Annual Report 2021 (Issue 45) **November 30, 2020**

Highlights

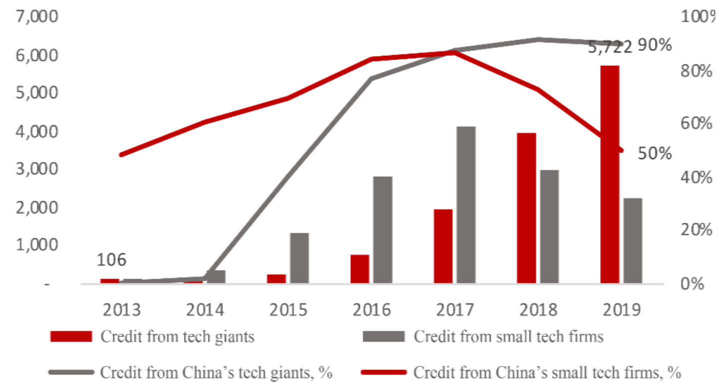
● In 2020, the global banking assets expanded against headwinds amid the COVID-19 pandemic. Banks across the world generally experienced narrowing interest rate spreads, deteriorating quality of assets, weakening profitability and adequate capital. The Chinese banking sector showed stable operation, solid expansion in assets and liabilities, gradual restoration in profits and relatively stable quality of assets.

● Looking into 2021, the global banking sector will manifest ten major trends of development, including the normalization of ccountercyclical supervision, slowdown in asset growth, U-shaped recovery of profits, mounting pressure of financial risk prevention and control and refinement of corporate credit modes.

● 2021 marks the first year of China's 14th Five-year Plan. In the face of a "dual circulation" development pattern, the Chinese banking sector will usher in a new stage of development. This report will, under the theme of "banking development in a 'dual-circulation' development pattern during the 14th Five-year Plan period", place the focus on two issues, namely the building of ecosystem scenarios in the Chinese banking sector and the adoption of Equator Principles in the Chinese banking sector.

Changes in Global Tech Credit in 2013-2019

unit: USD100 million



Source: BIS, CCAF, BOC Research Institute

Source: Central banks and regulatory authorities, financial statements of banks

BOC Research Institute
Global Banking Research Team

Team leader: Chen Weidong

Team members: Wang Jiaqiang
Shao Ke
Xiong Qiyue
Yuan Xiaohui
Li Mengyu
Zheng Chenyang
Zhang Zhuo (Hong Kong)
Yu Yigong (Sydney)
Wang Zhe (Tokyo)
Qu Kang (London)
Lu Mengchu (Russia)
Yang Bo (Hungary)
Jiao Peng (Johannesburg)
Huang Xiaojun (New York)
Shi Xiaodong (Brazil)

Contact: Wang Jiaqiang
Telephone: 010-66592331
Email:
wangjiaqiang@bankofchina.com

New Trends under China's "Dual Circulation" Development Pattern

– Global Banking Industry Outlook (2021)

The COVID-19 pandemic sent the world economy into a deep recession in 2020. Global banking assets expanded against headwinds. Banks across the world generally experienced a widening gap between growth rates of deposits and loans, sharp contraction in profits, narrowing net interest margin (NIM), deteriorating quality of assets and a good level of capital adequacy. The Chinese banking sector showed stable operation, solid expansion in assets and liabilities, gradual restoration in profits and relatively stable quality of assets. In 2021, the banking sector is expected to manifest ten major trends of development, including the normalization of countercyclical supervision, slowdown in asset growth, U-shaped recovery of profits, mounting pressure of financial risk prevention and control, and refinement of corporate credit modes. 2021 marks the first year of China's 14th Five-year Plan. In the face of a "dual circulation" development pattern, the Chinese banking sector will usher in a new stage of development.

I. Overall Review of Global Banking Development

I.1 Global banking environment and results in 2020

The global banking sector was challenged by a deep economic recession, global market turbulences and a monetary environment with low interest rates in 2020. The global banking sector showed the following characteristics:

Total assets kept expanding against headwinds. Banking assets expanded relatively fast amid strengthening countercyclical regulation across the world. The total banking assets of the developed economies including the US, the euro area and Japan are estimated to reach USD56 trillion at the end of 2020, up 5.7% YoY. Russian banking assets will reach USD1.7 trillion, up 11.8% YoY; Thailand, Indonesia and Malaysia recorded 8.6%, 7.2% and 5.9% in growth rate of banking assets, respectively. South Africa's banking assets will grow by 10%.

Credit expansion was significantly divergent among economies. Some countries stepped up countercyclical credit supply. The balance of loans in the US banking sector is expected to reach USD11.3 trillion at the end of 2020, up 7% YoY, 3.4 percentage points faster than that of the end of 2019. Meanwhile, credit expansion slowed down or even turned into a contraction in some countries and regions. Bank loans in the euro area are estimated to grow by 1.83% at the end of 2020, down 2.6 percentage points YoY. The balance of bank loans of Japan and Australia will grow by 1.8% and 0.6%, down 2.4 percentage points and 2.8 percentage points from the end of 2019, respectively.

Risk aversion continuously widened the gap between growth of deposits and loans. Economic entities are much more motivated to prevent risks amid the COVID-19 pandemic, having significantly stronger demand for lower-risk deposits (covered by deposit insurance). Considering risks in the real economy, banks did not convert all new deposits into loans and chose to hold them in the form of lower-risk government bonds and even placements with the central bank. The balance of deposits in the US banking sector is expected to reach USD16.9 trillion at the end of 2020, up 16.5% YoY, with the gap between growth of deposits and loans reaching 9.5 percentage points. At the end of 2020Q3, the euro area's banking sector recorded a gap of 9 percentage points between growth of deposits and loans. At the end of FY2020, Japan's banking sector is expected to record a gap of 3.6 percentage points between growth of deposits and loans.

Profits fell sharply with a narrowing net interest margin. In 2020 H2, notable recoveries were achieved in some economies. The surge in credit impairment allowances was subdued across the global banking sector and profitability improved gradually. Compared with 2019, however, banking profits still dropped sharply in 2020. The US and the euro area's banking sector experienced a steep fall in net profit by 68.9% and 59.4% YoY, with ROA down 0.37 percentage point and 0.30 percentage point, respectively. Australia's banking sector recorded USD20.9 billion in net profit, down 11.2% YoY, and that figure for Japan was USD12.4 billion, down 19.7% YoY. The markedly narrowing NIM of banks in the global context of low or even negative interest rates was part of the drag on profitability. In 2020, the US, the euro area, Japan and Australia are expected to demonstrate a NIM decline of 43 bps, 13 bps, 5 bps and 10 bps in the banking sector, respectively.

The quality of assets deteriorated, but the potential credit risk has not surfaced in a large scale. Major economies' balance of NPLs climbed in 2020 across the banking sector, which drove up the NPL ratio, albeit slightly. The balance of NPLs in the US, the euro area, Japan and Australia as developed economies is estimated to grow by 9.87%, 1.45%, 9.73% and 24.67% at the end of 2020, respectively, with their NPL ratios rising by 3 bps, 10 bps, 21 bps and 3 bps accordingly. The balance of NPLs did not surge in a large scale for multiple reasons. On the one hand, national governments launched relief policies, such as large-scale guarantees and interest subsidies, to significantly mitigate NPLs. On the other hand, as credit supply was strengthened amid the COVID-19 pandemic, no risk of loan default emerged in the corporate or household sector. In 2021, credit risk will remain under the pressure of finding its way out amid the global uncertainties in pandemic containment and economic recovery. Relevant risks deserve vigilance.

The capital adequacy ratio (CAR) showed stable movements, providing strong risk resilience. All countries have tightened capital supervision since the crisis. The global banking sector as a whole maintains a relatively adequate level of capital to ensure strong risk resilience. At the end of 2020, the US, the euro area, Japan and Australia are expected to record a CAR of 14.73%, 19.35%, 17.8% and 16.15%, up 3 bps, 115 bps, 51 and 45 bps, respectively. Since the COVID-19 pandemic began, the US, the UK and the EU have suspended or stopped banks' dividend distribution and stock buybacks, among others, to help banks strengthen their capital sources.

I.2 China's banking environment and results in 2020

1. 2020Q3 review of China's banking sector

In the late phase of the pandemic when China staged a V-shaped economic recovery, commercial banks' Q3 results beat expectations, showing the following overall characteristics: **First, assets and liabilities expanded steadily.** At the end of Q3, commercial banks recorded a YoY growth rate of 11.7% and 11.8% for total assets and total liabilities respectively. **Second, the quality of assets remained stable.** Commercial banks' balance of NPLs stood at RMB2.84 trillion at the end of Q3, up 19.8% YoY, representing a NPL ratio of 1.96%, up 0.02 percentage point from the end of Q2. **Third, the decline in net profit slowed down.** Commercial banks realized RMB1.5 trillion of net profit accumulatively in the first three quarters, down 8.3% YoY, a slowdown in decline by 1.1 percentage points from H1, and the Q3 net profit rose by 14.2% from Q2. **Fourth, risk resilience was strong.** Commercial banks registered a provision coverage ratio (PCR) of 179.9% at the end of Q3, down 2.52 percentage points from the end of Q2, showing a slowdown in YoY decline from one quarter ago. The CAR was 14.41%, up 0.20 percentage point from the end of Q2.

2. Changes in China's banking environment in 2020Q4 and their impact

The rapid macro-economic recovery has fortified the foundation for banks' solid growth. China's Q4 GDP gained about 5.8% YoY, representing faster YoY growth than in Q3. The annual GDP growth is projected to be around 2.2%. With consumer confidence marginally restored, consumer finance is embracing new growth opportunities under the "dual circulation" development pattern. Service consumption is improving at a faster pace and production is recovering, while the strong financing demand of businesses drives the growth of banks' corporate lending and inclusive finance. As part of the government's efforts to strengthen weaker areas in conventional infrastructure, new infrastructure projects have created project investment and financing and bond underwriting opportunities for banks.

As the monetary policy is returning to normal, the banking service demand expands steadily. M2, a measure of broad money supply, is estimated to expand by about 10.9% YoY in Q4, a further decline from Q3. The annual growth of M2 is projected to be 10.4%. M2 underpins the expansion of banks. The M2 slowdown becomes a drag on the expansion of the banking sector. Aggregate financing to the real economy shows a bigger size and better quality, expected to expand by about 13.5% YoY in Q4. The medium- and long-term loans will account for over 70%, with the lending structure further improved. Banks have sufficient liquidity to ease the pressure on liquidity management of assets and liabilities.

The sector witnesses intensifying competition and marked divergence among banks. State-owned large banks perform their social responsibility actively. Joint-stock banks step up efforts on retail banking focused on credit cards. Local banks, including city commercial banks and rural commercial banks, carry out customized and fine-grained management harnessing local advantages. These banks have shown significant disparities in growth rate of assets. At the end of Q3, the large banks, joint-stock banks, city commercial banks and rural commercial banks recorded 10.6%, 12.6%, 11.7% and 10.6% in YoY growth of total assets, respectively.

The financial policy focuses on risk prevention and strict governance. The PBOC and the CBIRC jointly issued the *Administrative Measures for Total Loss-Absorbing Capacity of Global Systemically Important Banks (Exposure Draft)* and the *Notice on Establishing Countercyclical Capital Buffer Mechanism* on September 30, imposing stricter requirements on the capital level and quality of global systemically important banks (G-SIBs). The PBOC issued the *Law of the People's Republic of China on Commercial Banks (Proposed Amendment)* on October 16, 2020. The proposal added chapters and sections on corporate governance, capital and risk management and other aspects of commercial banks, attaching greater importance to the corporate governance and risk management of commercial banks. The frequent issuance of financial regulatory policies in Q3 and Q4 suggests that the regulatory policies of commercial banks will be more focused on risk prevention and strict governance in the late stage of the COVID-19 pandemic, with the aim of making commercial banks more resilient to risks and improving their risk resolution mechanism.

3. Estimated annual results of China's banking sector in 2020

The balance sheet expansion is estimated to soften slightly. Commercial banks' assets and liabilities are estimated to maintain a growth rate of around 11% at the end of 2020Q4, a modest slowdown from the end of Q3.

The decline in net profit will continue to slow down. Commercial banks' net profit for 2020 is estimated to fall by around 7% YoY, a subdued decline when compared with Q3.

The asset quality tends to stabilize and improve. There is a time lag in releasing the risk of non-performing assets. Commercial banks are expected to experience a further rise in NPLs in 2020Q4, yet at a slightly slower pace than Q3. In addition, commercial banks will continue to strengthen write-offs in response to the eruption of risks to be worsened by withdrawal of policies postponing principal and interest repayments on loans. Thus the NPL ratio is estimated to be stable at around 2% with a tendency of upturn. Also, commercial banks will lessen their provisioning due to sufficient provisions already set aside. The PCR is estimated not to change much at the end of 2020Q4.

The capital replenishment capacity will improve. Encouraged by regulators to replenish capital through various channels, commercial banks attach greater importance to corporate governance and improving the long-acting mechanism for capital replenishment. Commercial banks' CAR is estimated to further pick up in 2020Q4 to stand at around 14.5%, back to the beginning level of the year.

The valuation of bank stocks will be further divergent. The 36 A-share listed banks are expected to keep their average P/B ratio at around 0.8x at the end of 2020Q4. The valuations of some listed banks may move higher on outstanding results. Banks will show greater disparities in valuation. Some banks will continue to lead the market by valuation performance.

II. Ten Trends of Global Banking Development in 2021

II.1 Countercyclical regulation will return to normal

The countercyclical regulatory policy will return to normal in 2021 against the backdrop of regular COVID-19 containment. The regulatory policy temporarily relaxed to cushion the fallout from COVID-19 outbreaks is likely to gradually restore to the pre-pandemic level. The CAR requirements, especially countercyclical capital buffer requirements, may increase due to countercyclical credit supply. The US, the euro area and the UK will probably cease to protect banks from dividend distribution. Banks will resume dividend distribution and stock buybacks. Some countries will launch regulatory policies deferred by the pandemic, such as Basel III (final version) policies and interest rate benchmark reforms.

In 2021, China will continue to build the banking supervision regime and shore up the weaker areas of supervision, in a bid to enable high-quality development in the banking sector. China's endeavor to refine the banking supervision policies may be focused on the following areas: Given the decreasing market concentration and ever-changing business modes in the banking sector, the business scope of banks will be gradually adjusted, and the banks' entry thresholds will be raised as appropriate. Greater crackdown efforts will be made on prominent problems discovered in small and medium-sized banks, including unsound corporate structure, shareholders' poor qualifications, insider control and non-complying related party transactions. As for new entities and business modes emerging in internet finance and shadow banking, the supervision of their functions and activities will be fortified to strengthen institutional building. As for the largest banks, global systemically important banks are encouraged to issue eligible TLAC bonds, issue a list of domestic systemically important banks and implement relevant regulatory requirements on capital surcharge, stress testing, data governance and recovery and resolution planning. As for small and medium-sized banks, differentiated regulatory measures will be actively implemented and the market-based exit mechanism for weak banks will be improved. Stronger efforts will be made to protect customers' interests by refining the protection rules for different categories of customers and strengthening customer data and information security in line with changes in international regulatory rules.

II.2 Expansion of the banking sector will slow down

The global banking sector is expected to maintain remarkable growth in assets and liabilities in 2021, yet at a lower rate than in 2020 due to the subdued impact of COVID-19 on the economy and intensity of countercyclical policies. Specifically, total assets will grow by nearly 9%, less than 5% and 3% to 4% in the banking sector of the US, the euro area and Japan respectively.

As the PBOC's monetary policy return to normal, China's commercial banks are estimated to show the following characteristics of balance sheet expansion in 2021: **The balance sheet will expand by 10% to 11%**, a subdued increase from 2020. **Medium- and long-term loans are expected to maintain rapid growth.** Commercial banks are expected to keep expanding their medium- and long-term loans rapidly in 2021, which will account for more than 70% of total loans. **The deposit structure tends to be adjusted.** Banks' structured deposit growth will soften in 2021 due to tightening regulatory policies. The growth in interbank CDs will be subdued to a certain degree as the market interest rates and credit environment change. The low-risk deposits covered by deposit insurance will gradually become more attractive.

II.3 U-shaped bounce-back of operating results

The global banking sector's growth of net profit will turn from negative to positive in 2021, moving out of the bottom area of the U-shaped curve. The US and Japanese banking sectors are expected to move into the positive territory, while the euro area is likely to have slower decline in the banking sector. The Chinese banking sector's net profit is estimated to bottom out in 2021 and grow at 2% to 3%, a negative-to-positive reversal. The main driving forces are as follows: **First, interest concessions to the real economy will decrease.** The interest concessions in 2021 will be less than RMB1.5 trillion made in 2020. The protracted, massive interest concessions to the real economy are detrimental to banks' capital buildup and risk resilience. As the real economy gradually recovers, banks' support for the real economy through interest concessions will return to normal. **Second, operating income will increase steadily.** In 2021, there will be limited downward space for market interest rates and lending rates, helping banks to cement NIM and interest income. With consumption in a recovery, the fee and commission income from bank cards and settlements hit hard by the coronavirus is likely to grow. Market entities' still-strong demand for bond issuance in a low-rate environment provides a growth opportunity for underwriting of bonds. Commercial banks' operating income is expected to grow by 6% to 7% YoY in 2021. **Third, operating costs tend to fall.** The use of FinTech helps further reduce the costs of labor, channels and operations and boost internal management efficiency. Relevant operating costs will be lowered accordingly. **Fourth, provisions erode less into profits.** China's banking sector will likely return to the normal pace and intensity of provisioning in 2021, eroding less into the net profit.

II.4 The pressure to prevent and control financial risks will continue to rise

The global banking sector will come under greater pressure to prevent and control financial risks in 2021. Due to the lag in credit risk release, major economies will find the NPL ratio further rising in the banking sector. The prices of sovereign bonds, credit bonds, commodities and other financial assets measured at fair value will become more volatile to incur paper losses of banks' proprietary assets and assets under management. Some currencies may suffer a temporary liquidity crunch. Over the medium and long terms, the rising risks of banks will eventually erode into profits, impairment allowances and capital, having an adverse impact on the sustainability of banking development. Global banking profitability will remain low in 2021. Some banks will face a major capital pressure, and smaller banks in emerging markets will be at higher risks.

The Chinese banking sector will remain in a tough situation of preventing and controlling financial risks in 2021, principally in the following aspects: **First, the pressure on asset quality will be gradually released.** The risks building up in the course of loan extensions and loan renewals without repayment of principal, which represent an increasing proportion, will be continuously released in 2021. The NPL ratio of commercial banks is likely to rise and hit 2.0% to 2.2% at the end of the year. City commercial banks and rural commercial banks will be under greater pressure to prevent and control the risks in asset quality, whose NPL ratio might reach a multi-year high. **Second, volatile prices of financial assets will cause paper losses.** Since the beginning of 2020, the volatile commodity prices, frequent defaults on domestic credit bonds and extreme price fluctuations of related assets have had major impact on the gains or losses on banks' wealth management and asset management products. Similar incidents are still possible in 2021. The risk management of banks' asset management products will become a tougher task. **Third, some financial institutions pose notable risks.** It is possible that the Baoshang Bank crisis will happen again to a few banks. Risks in the interbank loans, interbank deposits and capital instruments related to such banks deserve special attention. Commercial banks have been under mounting capital pressure (especially core Tier 1 capital) since 2020 began. The provision coverage ratio and liquidity coverage ratio fell from quarter to quarter, and some banks need to improve their loss-absorbing capacity as soon as possible. The banking sector will feel some pressure to capital, provisions and liquidity replenishment in 2021.

II.5 The corporate credit business mode will continue to improve

Corporate banking will remain exposed to the impact of COVID-19 containment, economic recovery and government supporting policies in 2021, expected to show the following trends of scale, industrial structure, income mix and work efficiency.

First, corporate credit expansion will soften. The development of global corporate banking is expected to be closely linked to the trajectory of economic recovery in 2021. If the pandemic can get contained fast, corporate banking will improve; otherwise, corporate banking may continue to weaken in terms of scale, asset quality and return on assets. China's Big Five banks recorded a YoY decline of 0.7 percentage point in corporate credit as a percentage of total credit in 2020H1. The share of personal credit is expected to further expand in 2021.

Second, the industrial structure of corporate credit will change. Large US and European banks estimate the debt servicing ability of enterprises more accurately by adjusting the credit and risk control models, directing new loans toward businesses at lower risk amid the coronavirus pandemic. Guided by the 14th Five-year Plan, the Chinese banking sector will strengthen credit supply to relevant fields and provide funding support for new economic modes, including infrastructure investment, transformation and upgrading of manufacturing industrial chains and intelligent manufacturing. As the philosophy of inclusive finance is further implemented, credit support will continue to increase for small and medium-sized enterprises and private businesses.

Third, the credit process will be further streamlined. Banks' credit extension will go beyond the traditional collateral- or guarantee-based approach to explore credit approval modes based on the business characteristics of corporate borrowers. For example, when it comes to small and micro businesses, unsecured lending will be pursued by applying an intelligent decision-making process where credit approval relies on customer data with greater openness. For technological innovators, the intellectual property collateral or other novel approval modes will be explored. For asset-light service providers with good cash flows, explorations will be made for granting credit based on the title to operating assets. The combination of online approval and offline review will also greatly boost the approval efficiency to meet customers' liquidity financing needs.

Fourth, more sources of non-interest income will be explored. Banks will actively explore new sources of non-interest income by controlling fee rate discounts and developing novel sources of transaction fees (e.g. channel income, API usage fee, advisory fee and operations service fee) to relieve the income pressure from shrinking interest rate spread. International large banks are making ongoing explorations for exporting bank payment and settlement capacities to peers, providing system and management capacities to smaller banks and increasing their sources of stable cash flows. The share of non-interest income in total income is expected to rise by 3 percentage points in 2021.

II.6 Consumer finance will recover markedly

The banking sector in developed countries will achieve a recovery in consumer finance in 2021, but should take the initiative in tackling possible risks. In the US, the failure to contain the coronavirus spreads promptly will put the credit card loans and residential mortgages at a risk of rapid deterioration in quality. In the Europe, the pandemic will have a continuing big impact on economic development. Consumer finance will be curbed somewhat and outstanding transactions will pose a rising potential risk.

Developing countries will achieve faster development in consumer finance through 2021. For example, Southeast Asia's consumer finance market has a huge growth potential due to the broad coverage of mobile internet and the long time spent on internet use. Banks will implement the strategy of building financial service scenarios in a faster pace and seek to create strategic partnership with giant retainers and e-commerce platforms.

China has witnessed consumer finance mushrooming in recent years. In 2021 when the country will seek to create a "dual circulation" development pattern, consumption will further play a critical role in boosting the domestic and international dual circulations, become the core driver of the domestic market and a major power to improve the industrial structure. On that basis, the balance of personal short-term consumer credit will grow by about 15% YoY, and personal consumption loans (including housing loans) will grow by nearly 20% YoY in 2021. The development of consumer finance will show the following characteristics:

First, the scenario-based finance will enter a new phase of tapping deep into potential. The growth shifts to an "online and offline" dual mode. Online and offline scenarios will be integrated faster to tap into the potential demand of consumers in every respect. Explorations for the vertical development mode will be sped up to extend financial services through the entire industrial chain, including manufacturing, logistics and transportation, wholesale/retail and final consumption, and to boost the in-depth integration of consumer internet and industrial internet.

Second, "non-contact" financial services are growing faster. The way of customer acquisition is diversified. Products and services are shifting faster to remote talk, "unmanned banking" and other novel service modes. The application of debt collection "robots" and blockchain technologies is accelerated.

Third, the customer base is further diversified, showing a more pronounced feature of moving downward to lower-tier cities and inclusive finance. Financial services market is nearly saturated in first-tier and second-tier cities, including Beijing, Shanghai, Guangzhou and Shenzhen. Consumer finance will further extend to the young and the low- and medium-income groups. Third-tier and fourth-tier cities as well as the broader county areas will become major destinations for consumer finance expansion, and the key battlefield for consumer finance institutions.

Fourth, the interest rate spread challenge dampens the profitability of consumer finance. Banks and other financial institutions face intensifying competition in the market, pushing the customer acquisition costs significantly higher. Consumer finance institutions also find their costs of funding and post-lending management rising to various degrees. The Supreme People's Court issued an amended regulation in August 2020, capping the protected interest rate of private lending at four times LPR. That means the past practice of covering higher costs with higher interest rates can no longer be used. The spread space for consumer finance is squeezed and the profits will shrink accordingly.

Fifth, the asset quality problem is emerging. The risk in lower-tier customers has to been addressed urgently. There is a lack of credit report data for customers located in lower-tier cities, so their ability to pay is highly uncertain and the crackdown on microcredit dishonesty is not strong enough. Risk management of relevant consumer finance is a big difficulty. In addition, consumer finance defaults are a major problem in the field of consumer finance.

II.7 Cross-border operation will be focused on Asia Pacific

Looking into 2021, large multinational banks will focus their global presence more on the Asia Pacific market, and the cross-border finance will take new business forms.

First, large multinational banks will continuously cut back on their presence in Europe and North America. HSBC's pre-tax profits in Europe and North America lost a total of USD2.95 billion in 2020Q1-Q3. Citigroup's pre-tax profits in North America stood at USD1.938 billion, down 60% YoY. Looking into 2021, the US presidential election and the post-Brexit negotiations will be the major uncertainties affecting large multinational banks' European and North American presence. The low interest rates will keep squeezing the profit space for banks. Large multinational banks' overseas presence in Europe and North America may continue to shrink or get rebalanced.

Second, large multinational banks' presence and investment in Asia Pacific will expand. The large multinational banks' profits in Asia Pacific are estimated to fall YoY in 2020, yet to a less degree than in other regions. Their profit drop was concentrated in 2020 H1, showing obvious improvements in 2020 H2. China, Japan, South Korea, Australia, New Zealand and the ASEAN signed the *Regional Comprehensive Economic Partnership* (RCEP) on November 15, 2020. This agreement will further boost the economic connectivity and flows of production factors within the region and create larger and more diverse demand for cross-border financial services.

Third, large multinational banks face great uncertainties in the Middle East, Africa and Latin America. In the Middle East, Africa and Latin America, the major uncertainties in economic recovery and COVID-19 containment pose a great challenge to banks seeking business development in these markets. Multinational banks with a small share in these markets may cut back on or even discontinue part of their local businesses. For large multinational banks present in these regions for many years, such as Santander in Latin America and Standard Chartered in the Middle East and Africa, may maintain their current local presence and take a cautious stance toward long-term business development in these markets.

Fourth, the changing environment will spur new ideas about compliance management. Statistics show that global financial institutions were fined for as much as USD5.6 billion due to money laundering, KYC violations or other non-compliances from January to July 2020. Banks will further allocate more technological, human and financial resources to compliance management. The uncertain and ever-changing external environment will force banks to update their compliance policies and procedures in a faster pace, making their compliance management of cross-border finance more dynamic and forward-looking. At last, national supervision may be further fragmented amid the pandemic. Banks will probably appoint compliance officers in regional centers in a more refined manner for differentiated compliance management across regions or markets.

Fifth, the rebalancing of industrial chains will boost new business breakthroughs. The deepening of China-EU cooperation, high-quality development of the Belt and Road Initiative and the RCEP agreement will make banks' customer base for cross-border financial services more regional and more connected to neighboring countries. In China's banking sector, in creating a "dual circulation" development pattern, the target recipients of cross-border financial services will shift from the dominance by "going global" customers to equal emphasis on "going global" and "bringing in". In addition, the financial service demand will further expand in manufacturing and high-tech sectors experiencing a new round of industrial transformation and upgrading.

Sixth, technological advancement will reshape the landscape of cross-border finance. In the field of cross-border trade finance, such technologies as blockchain, optical identification and intelligent identification have been broadly applied to international documentary credits and guarantees. Cross-institutional data sharing and data integration platforms will effectively ease the problem of repeated trade finance and trade finance frauds. The digital currency explorations and development will reshape the cross-border payment ecosystem. Banks may achieve new breakthroughs in the related cross-border payment, settlement and clearing systems. The efforts to build digital platforms and develop digital banking will give an impetus to cross-border retail banking.

II.8 Inclusive finance will speed up digital development

Inclusive finance gained pace amid the pandemic in 2020. First, fiscal support was intensified. National governments helped individuals and businesses through the severe COVID-19 shocks by launching the remuneration protection scheme, non-recourse loans and tax cuts, abatement and rebates. Second, financial institutions expanded credit supply. As at the end of 2020Q2, China's banking institutions issued RMB13.73 trillion of inclusive finance loans, up 28.4% YoY. Third, loan repayments were rescheduled flexibly. The principal repayment on RMB1.44 trillion of loans to 506,000 businesses and self-employed individuals was deferred during June and July 2020. Looking into 2021, the pandemic will speed up the development of online financial services and digital finance platforms, with digital inclusive finance expected to make new breakthroughs.

First, online financial service models will be increasingly diversified to supplement or replace offline services in a faster pace. COVID-19 lockdowns and social distancing forced all financial institutions to set up "non-contact" service channels using digital technologies, accelerating the substitution of online services for offline services. As at November 16, 2020, a total of 2,938 bank outlets were closed while 2,198 outlets were established or relocated, representing a net decrease of 740 outlets. The broad application of mobile banking, facial recognition and identification technologies enable good geographic penetration of inclusive finance by virtue of internet. Digital inclusive finance platforms will emerge faster to supplement the existing inclusive finance service system.

Second, FinTech will be broadly applied in inclusive finance to boost service efficiency. The innovative application of big data mining, artificial intelligence and cloud computing will enable financial institutions to analyze users' eligibility and risk profile from various perspectives, thus increasing the accuracy of risk identification and substantially lowering the costs of inclusive finance services. Financial institutions may provide users with more convenient, quicker and more reliable credit support through remote face-to-face signing, online credit examination and intelligent risk control. Financial services will be provided more efficiently. Looking into 2021, a fully online and digital credit process will become a fresh trend to greatly boost the efficiency of inclusive finance.

Third, data infrastructure will be improved faster to fortify the foundation for inclusive finance services. The existing "digital gap" hides some populations from the "radar" of financial service providers. IT infrastructures will be further improved to make digital financial services more accessible. All financial institutions will make further optimizations and upgrading for security of systems, models, funds and data, in a bid to create a healthier and securer inclusive finance ecosystem.

II.9 "Tech credit" may enter a phase of steady and sustainable development

The global credit market has been nurturing revolutions in recent years. Tech firms are stepping up their expansion into the credit market: On the one hand, internet platforms represented by P2P lenders extend credit via online trading platforms. On the other hand, tech giants[1] across the world have engaged in credit extension on their own or in partnership with financial institutions. The size of "tech credit" may bid farewell to explosive growth in 2021. Tech firms and financial institutions will further deepen their partnership and tech credit will enter a phase of steady and, sustainable growth.

First, global regulators will explore to adjust the regulatory framework for "tech credit". As a start, whether the impact of "tech credit" on consumers and investors will threaten the stability of financial system and fairness in the market; second, whether "tech credit" will give a boost to financial development, financial inclusiveness and efficiency; third, whether the existing financial regulatory framework includes mechanisms for effectively identifying, supervising and responding to risks in "tech credit" and whether there is any space for regulatory arbitrage.

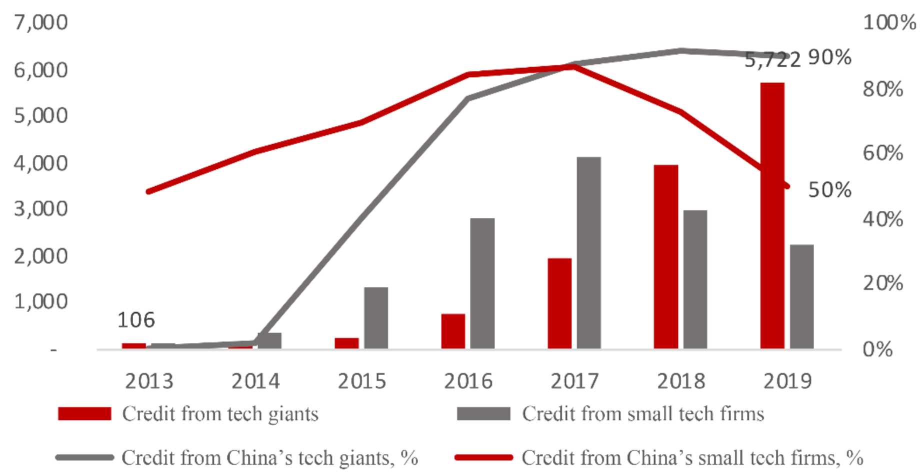
Second, tech giants may bid farewell to the explosive growth of credit size. According to statistics, the total credit extended by global tech giants rose from USD10.6 billion at the end of 2013 to USD572.2 billion at the end of 2019, representing an annual growth rate of 94% on average (Fig. 1). With the *Provisional Measures for Management of Internet Loans of Commercial Banks* and the *Provisional Measures for Management of Internet Microloans* promulgated, tech giants are facing stricter requirements on capital level and participation share in syndicated loans. Tech giants will make explorations for a more sustainable way and pace of credit extension. In 2021, China's

[1] Such as Amazon, Apple and Google in the US and Tencent, Alibaba, Baidu and JD.com in China.

adjustments to credit supply from tech giants are expected to affect the growth of global tech credit.

Fig. 1: Changes in Global Tech Credit in 2013-2019

unit: USD100 million



Source: BIS, CCAF, BOC Research Institute

Third, cooperation with financial institutions will become an important direction for tech firms' engagement in credit business. The partnership between tech giants and large financial institutions will create a "win-win" result for both sides in 2021. In Japan, ranked second worldwide by credit supply from tech giants, LINE as a major social media platform issues consumer credit products in partnership with Mizuho Bank. Telecoms carrier NTT provides credit assessment services for banks under agreements signed with banks and customers. Japan's second largest telecoms carrier KDDI joint-ventured smartphone bank Au Jibun with MUFG Bank. In the US, Apple and Goldman Sachs issued co-branded credit cards; Google and Citibank rolled out joint demand deposit accounts; Amazon and Goldman Sachs cooperated in developing consumer credit and other services.

II.10 Green finance will become a mainstream mode

Developed countries' banking sector will attach greater importance to environmental, social and governance (ESG) issues in 2021. In the US, as Joe Biden reportedly won the presidential election, environmental protection and the fight against climate change will become major concerns of the new administration. Green finance will gain traction in the US banking sector in 2021. In the UK, the government actively takes the green finance strategy forward, planning to spend GBP2.5 billion on innovative fields of clean growth and pledging to increase that figure to GBP22 billion in 2025. In Japan, Primer Minister Yoshihide Suga said in his first policy speech that Japan would achieve zero greenhouse emissions in 2050, suggesting further acceleration in green finance across the country.

In developing countries, green finance development will speed up in 2021, playing a crucial role in infrastructure investment. In Southeast Asia, a green finance framework will be gradually established or imported to shape a green finance policy system. This region will see a growing number of participants in the sustainable investment market and outstanding performance in green bonds, responsible investment, green funds and other green finance products. In Russia, more banks will create the local green finance system in accordance with the *Russian Guidelines on Green Finance*, grant concessional loans to domestic enterprises engaging in green projects and inject growth impetus into green enterprises.

China's green finance market has been expanded rapidly in recent years. In June 2020, the balance of green loans from major financial institutions reached RMB11.01 trillion, up 16% YoY. The annual green credit is expected to be RMB12 trillion for the year. The green bond issues in 2020 are estimated to maintain a growth rate of around 30%. In addition, China's pilot carbon markets have become the world's second largest by quota trading volume. At the end of August, the seven pilot carbon markets recorded RMB9.28 billion in total quota trading volume, and the annual figure is expected to break the mark of RMB10 billion.

Compared with people's growing demand for a better ecological environment, the road to green development and ecological conservation remains a long and bumpy one. China's green finance is expected to reach new heights in 2021 to become a mainstream business mode in the banking sector, mainly in two aspects:

First, green finance will expand rapidly to reach RMB16 trillion or so. Green finance will cover the entire banking sector, with disparities among banks. Green bonds will be developed vigorously, other forms of green finance will be actively explored, and some banks will develop uniform green finance brands that are influential in the market.

Second, the reform in systems and mechanisms will be deepened to strengthen environmental risk management. More banks will draw upon the best international practices to develop group-wide green development strategies encompassing green finance and environmental and social risk management and embed them into the management architecture of "board of directors and its committees –executive officers – performers". Specialized entities will be established and developed faster in pilot areas for green finance reform and innovation, including Zhejiang, Jiangxi, Guangdong, Guizhou and Xinjiang, thereby promoting professional operation.

中国银行
BANK OF CHINA

BOC Research Institute
1 Fuxingmen Nei Street, Beijing, 100818 China
Postal Code: 100818
Telephone: +86-10-66594097
Fax: +86-10-66594040