Priorities to win in the new world

APAC banks face challenging 2021 as small lenders hurtle towards mergers

Small banks could lose market share as digital newcomers target underserved segments.

Whilst news about vaccine development has spurred expectations of a global economic recovery in 2021, the outlook remains bleak for banks in Asia Pacific with analysts forecasting that the ill-effects of 2020's fiasco will linger on the credit profiles will linger throughout the year.

For 2021, analysts have pencilled in a slow, uneven economic recovery for the Asia-Pacific region. S&P banking analyst Ivan Tan forecasts a 6.8% GDP growth for APAC, in contrast with the 2% GDP contraction in 2020.

Although the region's economic outlook remains uncertain and vulnerable to COVID-19 infection trends, recovery has begun, albeit slow and uneven, notes EY Asia-Pacific banking and capital markets leader **Andrew Gilder**.

"As vaccines become available, and sentiments improve, revenue prospects for banks should start to stabilize, particularly in the second half of 2021," Gilder said.

But such a recovery would be long drawn, and APAC banks face a 2021 plagued with a prolonged period of depressed business and consumer spending, regulatory pressure on margins and fees, low interest rates, and increased operational costs due to COVID-19 safety measures will continue to weaken near-term profitability and tighten balance sheets.

Loan demand is expected to fall to an all-time low in 2021, reducing revenue from lending

The gloomy conditions make consolidations extremely likely, according to analysts.

"Most banks are entering 2021 with a contraction. Whilst economic growth will pick up across the region and recoveries should firm in H2 2021, return on equity will not revert to pre-pandemic values in the near term. This low-growth scenario could result in a significant reduction in banking capacity and accelerate industry consolidation for those that lack scale or differentiated capabilities," EY's Gilder noted.

Sumit Kumar, managing director and partner, Boston Consulting Group (BCG), echoed the same sentiment. "Consolidations are extremely likely, and could be commonplace in 2021, particularly in markets like Indonesia where weak demand and pressures on margins may be significant," Kumar told *Asian Banking and Finance*.

Apart from Indonesia, Japan and Taiwan are two other markets whose banks are likely headed towards mergers. "In markets that have been overbanked for years, such as Japan and Taiwan, a sharp fall in banks' valuations may be a catalyst for consolidation in 2021," said EY's Gilder.

Source: Boston Consulting Group

Banks with larger lending exposures to SMEs will also be vulnerable since smaller enterprises are the most impacted. "Whilst larger banks remain well-positioned to absorb potential non-performing loans (NPL) increases, some less well-capitalized smaller tier banks may struggle, and wind-up or get acquired," Gilder added.

Overall recovery will vary across APAC markets. BCG's Kumar notes that Malaysia, Indonesia, and Philippines reflect banking systems which are likely to see a slower recovery towards 2019 levels of activity. S&P Tan adds that countries where COVID-19 has led to a sharp recession or where the infection curve has been slow to flatten, such as India and Indonesia, will see a slow recovery.

Both analysts expect these markets to return to pre-COVID levels of performance in 2023 or beyond.

In contrast Singapore, Thailand, and Vietnam will recover faster, says Kumar. However, S&P's Tan notes that even for potential early-exiter banking jurisdictions from COVID-19, such as China and Singapore, recovery is not expected until end-2022.


Ivan Tan


Sumit Kumar

Moratoriums say bye

One of the biggest hurdles in the horizon for APAC's banking industries is the expiry of moratoriums, which began in late 2020 and is set to fully phase out by 2021, notes Tan.

"The moratorium on loans has allowed distressed borrowers hit by COVID-19 to defer interest and principal payments. The bulk of the moratorium will expire by the end 2020 or will be gradually phased out over 2021, which we believe could lead to higher non-performing loans appearing on bank's balance sheets," he said.

With moratoriums gone, lenders will feel the full brunt of the elevated unemployment levels on loan performance and credit costs over 2021, an effect that will likely spill over to 2022, adds Gilder.

The financial impact of the pandemic will also likely lead to a surge in NPL, says Kumar.

"Given the widespread disruption to earnings for both individuals and businesses, this is more a question of 'when', and not 'if'. Many of these non-performing loans are hidden currently by government financial support, and are likely to emerge on the books as we progress through 2021," Kumar said.

Kumar further expects that the loan demand will fall to an all-time low, reducing revenue from lending. Low net interest margins, combined with excessive liquidity, will also create further pressures on the margins.

"The coming months will require regional banks to manage growing distressed debts and conserve their capital," he said.

Wealth, investment to prosper

Despite the gloom and doom in the horizon for banks, there are segments that will likely perform well in 2021.

Kumar says that products related to wealth management, Lombard financing, and insurance will be the primary drivers of growth for banks and financial institutions in 2021.

"A recent BCG survey revealed that 15% to 18% of customers will increase their focus on wealth creation and protection products, whilst more than 25% of customers expect to delay large ticket purchases such as homes and automobiles," according to Kumar.

Gilder also identified private banking and wealth management as profitable growth opportunities, with Singapore banks noted to be seeing good momentum in this segment recently.

Amongst business lines, investment banking divisions that capitalise on market volatility may see their trade activity decline as markets stabilise. But IPO activity may experience a resurgence in 2021, boosted by companies that delayed listing last year.

Mergers and acquisitions are also expected to continue as weak valuations present acquisition opportunities, whilst restructuring and consolidation initiatives increase.

Post-pandemic paradigms

Apart from the challenge of tiding through the year, banks also face the prospect of preparing themselves to thrive post-pandemic.

Banks preparing for a post-pandemic world will find that growth opportunities are harder to come by, says EY's Gilder. As a result, most are resorting to accessing new, but riskier revenue streams to boost earnings.

This includes expanding into emerging markets, taking on more unsecured short-term consumer lending, shifting down the credit curve, or making investments in higher-risk securities.

To build sustainable returns in the long term, Gilder recommends banks to consider a set of baseline products, with complimenting ala carte add-ons for an additional charge. Such "plug-and-play" experiences and subscription models reportedly allow banks to price more transparently, yet improve their pricing power, increase fee-based income, and deepen client relationships.