The Economist INTELLIGENCE UNIT

Finance in 2021

A report by The Economist Intelligence Unit

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The Economist INTELLIGENCE UNIT

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Contents

Finance in 2021: a rocky recovery

Key forecasts:

- Financial firms will face weak demand for their services, ultra-low interest rates and mounting defaults by businesses and households in 2021.
- Robust levels of reserves, base capital and liquidity should allow most firms to survive.
- Separately, the UK and Hong Kong will begin to chart new courses as financial centres.

Pace of the recovery

Most financial firms have managed to survive the global economy's current disease- and recession-wracked conditions, and will continue to do so in 2021. Next year will remain ugly as economies start a tepid recovery. Banks, insurers and other financial firms will draw on the stronger base capital and liquidity that they have built up over the past decade to soldier on until conditions improve, a development that will depend less on finance than on medicine.

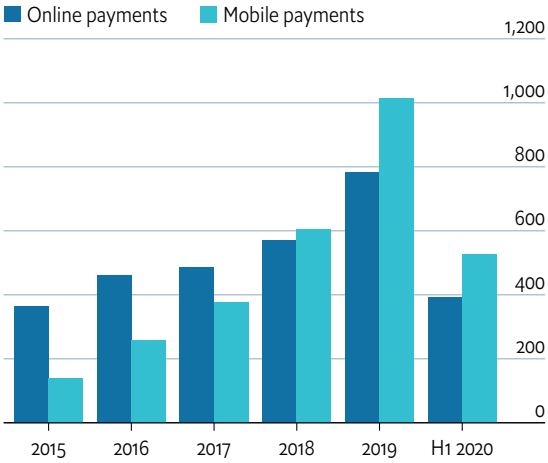
Fortunately for the sector, there was no major freeze up in essential markets in early 2020 when the pandemic hit, nor was there a run on deposits like those experienced in some markets in 2007-08. No major financial firms had to be bailed out by governments and taxpayers.

Unfortunately, conditions for financial firms are likely to grow tougher over the next year. A weaker economy in general will hurt financial businesses. Households and businesses suffering from reduced incomes are likely to cut back on purchases, including those involving financing and insurance coverage. Discretionary financial products in particular—such as for new cars, pension plans and holiday spending—could see demand tumble.

Historically low interest rates—known as "lower for longer"—will not help. They will leave little room for the margins between deposits and lending rates that generate most bank income. They will make it difficult for insurers to earn investment income and will spur investors to scrutinise, and reject, the fees that asset managers want to charge.

Nevertheless, low interest rates will be essential if countries, businesses and individuals are to manage their debts in 2021. If financial firms can withstand their effects and remain solid over the next year, then they will be poised to enjoy the recovery without the major legislative changes that followed the 2008-09 financial crisis.

Chinese shoppers click to pay
(digital payments; m transactions)



Source: People's Bank of China via Haver Analytics.

Four key trends for 2021

Governments will support the financial sector, but less so than in 2020

The relative stability of the financial system, compared with the situation in earlier crashes, is a result of rapid interventions of central banks, which cut interest rates, provided official lending and agreed to currency swap lines among themselves. It is also a result of the improvements in financial firms' resilience because they met Basel III standards, and related rules, that bolstered their balance sheets. Following the initial panic, volatility and its dangers are now unlikely to return in 2021.

Governments in developed markets also put in place vigorous stimulus packages to support companies and workers in early 2020, but these are likely to fade in 2021 as their heavy fiscal costs become apparent (see chart). The US has already rolled back support for businesses and the jobless, while European governments are making plans to do so as well.

Poorer countries were never able to afford such measures in the first place. However, they can take some solace in a new approach by the IMF and other global lenders to be generous in lending packages and relatively lenient in the conditions attached to them.

Banking-sector risks will mount in some countries

With less government support, we expect financial distress to rise. Bad loans have remained manageable so far in most markets, but we anticipate that they will start to pile up as firms in less-fortunate sectors—such as hospitality, travel, bricks-and-mortar retail and commercial real estate—fail and default on their obligations. Likewise, financially strapped households will run through their emergency savings and will have to decide which bills to skip, whether on home loans, car payments or credit card balances. So far, many stressed borrowers have taken advantage of government-decreed or voluntary forbearance programmes, but these will begin to wind down in 2021.

Most big banks worldwide set aside large chunks of their profits in the first three quarters of 2020 to cover future loan losses, following new global accounting rules that recently took effect. The lenders that did not build reserves will probably have to do so in the coming quarters. Those with the strongest reserves have now put aside sums equivalent to 3% or more of their total loan portfolios. Losses could rise even higher than this, forcing banks to divert more profits to reserves.

Digitalisation will offer opportunities for online finance

Some types of financial firms will benefit from the new environment. For example, as consumers have adapted to lockdowns and quarantines, they have turned to digital and contactless payments, including for burgeoning e-commerce purchases. Capital markets operators will enjoy a surge in new business, satisfying corporate demand for bonds and drawdowns on credit lines. The rebound in equities, especially among technology stocks, will attract new listings requiring underwriting services.

In many ways the Covid-19 crunch has accelerated on-going trends in financial services. Customers, who were already flocking to online portals and mobile apps, will now be less likely to visit branch locations. This will allow cost-conscious financial firms to cut back on these expensive outlets and their teams of employees. Automation of tasks as diverse as damage claim processing and trade reconciliation will also permit cost-cutting. Passive investment funds, largely led by index-tracking algorithms, are much cheaper than active funds with highly paid star portfolio managers.

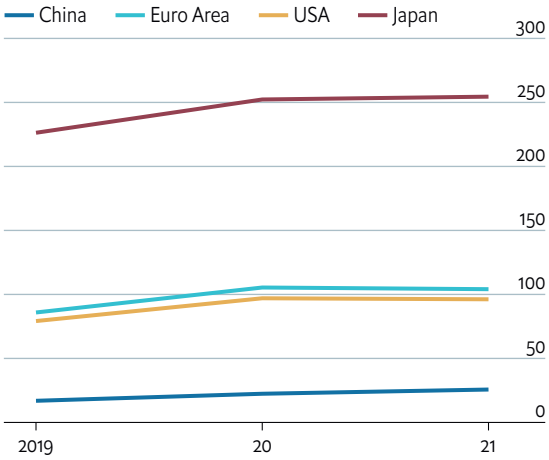
A shift in international hubs will affect Hong Kong and London

We anticipate the beginning of a major shift in financial centres starting in 2021. Although the process will take many years to play out, London and Hong Kong will have to trim their global ambitions and focus increasingly on national economies. Brexit is likely to result in UK financial firms losing "passporting" rights to operate across the EU in 2021. They will gradually shift responsibilities and jobs to locations in Frankfurt, Paris, Dublin and Luxembourg in the coming years, especially if the EU insists that firms do so. For London, the core problem is that more UK business cannot make up for less EU activity.

Meanwhile, China's suppression of autonomy in Hong Kong, under its National Security Law, will make the city a less appealing business location, including for financial firms. Although the city will retain its deep capital markets, vibrant financial ecosystem and well-developed legal system, the reduction of personal liberties and the postponement of scheduled elections will drive away firms that rely on free exchange of information, financial discretion and data security.

China's growing financial needs—combined with new dual listings of many firms now traded overseas—are likely to bolster securities markets and investment banks. However, global companies in pan-Asian or global insurance, asset management and private advisory will look for a new base of operations. In short, basic business for China will compensate for a loss of sophisticated pan-Asia activities.

Japan's heavy debts
(public debt; % of GDP)



Source: The Economist Intelligence Unit.

What to watch for in finance in 2021

A phase-out of UK-EU financial links

From January 1st 2021 Britain-incorporated financial firms lose their "passports" giving access to conduct business in the EU27, and EU-based firms lose similar rights in the UK. However, some transitional arrangements remain in place: EU banks can continue to use some London-based clearing services until June 2022. In April Irish corporate bonds and exchange-traded funds must move their clearing location to the EU27. They are slated to shift to Brussels-based Euroclear Bank, from London-based Euroclear UK & Ireland.

Giving up on Libor

After 2021 financial firms and contracts must abandon Libor (London interbank offered rate), a venerable but scandal-scarred benchmark for US dollar interest rates. The benchmark for US dollar lending, like that in other currencies, is moving to actual market rates rather than the average of banks' quotations that undergirded Libor. The Secured Overnight Financing Rate (SOFR) is the designated replacement of the US dollar Libor.

A rare female boss at a big bank

Jane Fraser has been appointed as CEO of Citigroup, the most international of the US's big bank groups, effective February 2021. The Scottish-born banker, currently the head of its consumer division, will seek to relaunch the firm, perhaps by further trimming its formerly far-reaching overseas activities.

2021 calendar

January

14: Citigroup, Wells Fargo report 2020 results
15: JP Morgan, Bank of America reports 2020 results
20-21: Bank of Japan's first monetary policy meeting (outlook report)
21: European Central Bank (ECB) monetary policy meeting
26: UBS Group reports 2020 results
26-27: First US Federal Reserve meeting (Federal Open Market Committee)

February

04: Deutsche Bank reports preliminary 2020 results
11: Barclays reports 2020 results
18: Credit Suisse reports 2020 results
19: Allianz, Swiss Re reports 2020 results
22: HSBC reports 2020 results

March

11: ECB's monetary policy meeting
16-17: Second US Federal Reserve Meeting (summary of economic projections)
18-19: Bank of Japan's second monetary policy meeting
24: Minutes of Bank of Japan's first monetary policy meeting
25: General Council meeting of the ECB in Frankfurt

April

14: JP Morgan, Wells Fargo report Q1 2021 results
15: Citigroup, Bank of America report Q1 2021 results
22: ECB monetary policy meeting
22: Credit Suisse reports Q1 2021 results
26-27: Bank of Japan's third monetary policy meeting (outlook report)
27-28 Third US Federal Reserve meeting (Federal Open Market Committee)
27: UBS Group reports Q1 2021 results
28: Deutsche Bank reports Q1 2021 results
30: Barclays, Swiss Re report Q1 2021 results

May

06: Minutes of Bank of Japan's second monetary policy meeting
12: Allianz reports Q1 2021 results
18-20: FINRA Annual Conference, Washington DC, US

June

10: ECB monetary policy meeting
15-16: Fourth US Federal Reserve meeting (summary of economic projections)
17-18 Bank of Japan's fourth monetary policy meeting

23: Minutes of Bank of Japan's third monetary policy meeting
24: General Council meeting of the ECB in Frankfurt

July:

13: JPMorgan reports Q2 2021 results
14: Citigroup reports Q2 2021 results
15-16: Bank of Japan's fifth monetary policy meeting (outlook report)
16: Wells Fargo, Bank of America reports Q2 2021 results
22: ECB monetary policy meeting
22: Minutes of Bank of Japan's fourth monetary policy meeting
27-28: Fifth US Federal Reserve meeting (Federal Open Market Committee)
28: Deutsche Bank, Barclays report Q2 2021 results
29: Credit Suisse reports Q2 2021 results
30: Swiss Re reports Q2 2021 results

August

06: Allianz reports Q2 2021 results
09: ECB monetary policy meeting
21-22: Bank of Japan's sixth monetary policy meeting; Sixth US Federal Reserve meeting (summary of economic projections)
28: Minutes of Bank of Japan's fifth monetary policy meeting

October

13: Citigroup, JPMorgan report Q3 2021 results
14: Bank of America, Wells Fargo report Q3 2021 results
21: Barclays reports Q3 2021 results
27: Deutsche Bank reports Q3 2021 results
27-28: Bank of Japan's seventh monetary policy meeting (will release outlook report)
28: ECB monetary policy meeting
29: Swiss Re reports Q3 2021 results

November

02: Minutes of Bank of Japan's sixth monetary policy meeting
02-03: Seventh US Federal Reserve meeting (Federal Open Market Committee)
10: Allianz reports Q3 2021 results

December

02: General Council meeting of the ECB in Frankfurt
16: ECB monetary policy meeting
14-15: Eighth US Federal Reserve meeting (summary of economic projections)
16-17: Bank of Japan's eight monetary policy meeting
22: Minutes of Bank of Japan's seventh monetary policy meeting
31: Inter-Bank offered rates to be replaced or reformed by end-2021, according to Financial Stability Board

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