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Modern Trends in Global Banking Development & Scenario

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ABSTRACT

For the global economy, the year 2010 was replete with a mixed sense of optimism and concerns. The optimism was attributed to a somewhat encouraging 'two speed' recovery, in advanced and emerging economies, after a major slump in economic growth in 2009 following the financial crisis. The concerns, however, were on account of escalating sovereign risks in the Euro zone and heightened inflationary pressures marked by uncertainty in the Middle East and North Africa (MENA) region. The beginning of 2011 has seen the optimism giving way to greater concerns on account of a projected slowdown of the global economy in general, and the US economy in particular, for 2011. Further, sovereign risks have strengthened even in the US with an increase in sovereign debt ceiling along with a downgrading of the rating of the US sovereign by the credit rating agency of Standard and Poor's.

In this milieu, the performance of the global banking system too has been characterised by a mixed bag of a few positive developments and a number of shortfalls. The positive developments have been in terms of the efforts by countries towards revamping their regulatory and supervisory architecture learning from the crisis, along with an effort to step up capital adequacy of banks. The major shortfalls, however, have been the lack of a widespread revival of the global banking activity, which could be characterised by improved credit growth, profitability and asset quality, and lower leverage.

Against this setting, this chapter analyses the performance of the global banking system using major indicators of banking activity and soundness for select advanced and emerging economies. It also looks into the detailed individual performance of the banking systems in few advanced and emerging economies/ economy-groups. Finally, at the institutional level, it analyses the performance of the top-100 banks having major global presence. It then highlights the major regulatory and supervisory policy initiatives with regard to the global banking system during the year.

INTRODUCTION:

At the beginning of the 21st century, the biggest banks in the industrial world have become complex financial organizations that offer a wide variety of services to international markets and control billions of dollars in cash and assets. Supported by the latest technology, banks are working to identify new business niches, to develop customized services, to implement innovative strategies and to capture new market opportunities. With further globalization, consolidation, deregulation and diversification of the financial industry, the banking sector will become even more complex.

Although, the banking industry does not operate in the same manner all over the world, most bankers think about corporate clients in terms of the following:

- Commercial banking - banking that covers services such as cash management (money transfers, payroll services, bank reconcilement), credit services (asset-based financing, lines of credits, commercial loans or commercial real estate loans), deposit services (checking or savings account services) and foreign exchange;

- Investment banking - banking that covers an array of services from asset securitization, coverage of mergers, acquisitions and corporate restructuring to securities underwriting, equity private placements and placements of debt securities with institutional investors.

Over the past decade there has been an increasing convergence between the activities of investment and commercial banks, because of the deregulation of the financial sector. Today, some investment and commercial banking institutions compete directly in money market operations, private placements, project finance, bonds underwriting and financial advisory work.

Furthermore, the modern banking industry has brought greater business diversification. Some banks in the industrialized world are entering into investments, underwriting of securities, portfolio management and the insurance businesses. Taken together, these changes have made banks an even more important entity in the global business community.

NEW TRENDS IN BANKING:

Economy decides the progress of a bank. Lets know about some facts:

European banks will have to struggle and face competition from the US banks .The reasons for European Bank's decline is high costs, minimal price competition or innovation, and mediocre customer service.

European banks have to face declining economy.This has led banks to try to boost their performance by cutting costs.But they have to set up long term survival in the market.

Also, the banks cannot become efficient without implementation of technology .But neither technology, nor cost-cutting, nor the disposal of surplus assets will be sufficient to drive long-term growth. The banks need to renew their strategies. And they must start by focusing on organic growth, as opposed to growth through acquisitions.

Buying other banks is a passport to instant growth. But many acquisitions take up too much of top management's time for too long. Customer service tends to be neglected. And so does innovation, although innovation is precisely what is needed for organic growth: new products, new marketing capabilities and customer service skills, etc.

Renewing a strategy also means redesigning it at the international level. In Europe, with a few exceptions, banking is still a national industry. Even banks with a strong foreign presence are hampered by the lack of a clear international strategy. They tend merely to wait for the right moment and seize any opportunity that arises, neglecting strictly strategic considerations. European banks should be asking themselves what countries they can compete in best, what competitive advantages they might have in each country, and how resources and skills can best be transferred from the corporate center to their foreign subsidiaries.

Another key question is how much diversification a bank can tolerate. Currently, the trend is toward universal banks that offer every kind of service to every kind of customer. Yet there are limits to the range of services a single bank can provide efficiently. To date, the performance of some universal banks has been disappointing. Exactly what advantage they have over more specialized banks remains unclear.

The banks need to have a proper structure in their firm but some banks, retain structures that are at odds with their strategy. Their international activities are not consistently integrated. Many banks, for example, are still divided into business units such as "retail banking," "corporate banking," "advisory services," etc., along with an "international division."

Outsourcing and off shoring will play an important role in determining the form banks take in the future. Corporate governance issues pose another serious challenge. The many changes the industry has undergone make it imperative that banks executive committees be equal to that challenge.

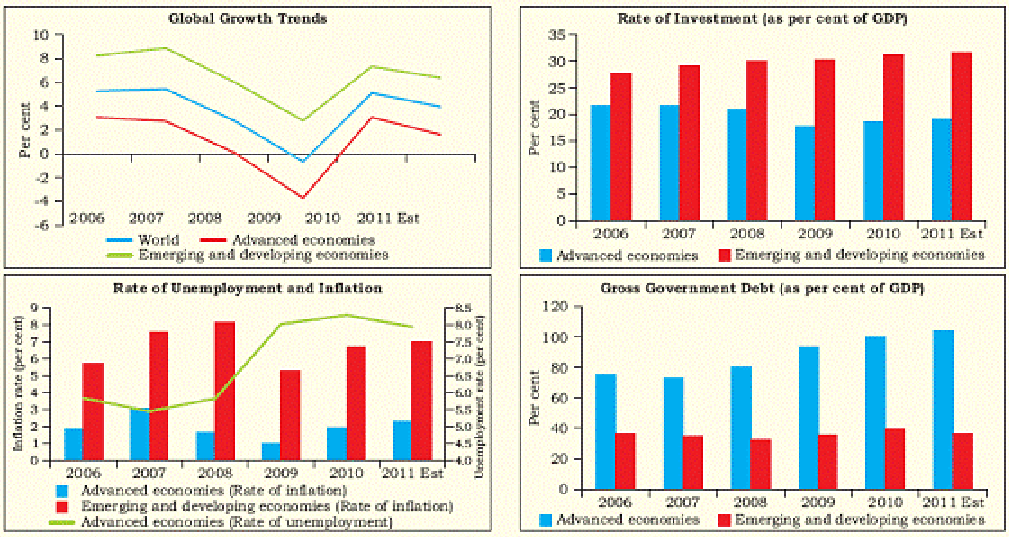
There are certain aspects of the business that make banks special. Risk management is one of them. There is great complexity involved in operating in a regulated industry without any protection against competition. Market pressure is a clear threat to established banks. The need to make a profit may drive some of them to pursue unacceptably risky transactions. Banks need executive committees that understand this danger and have the necessary prudence and skill to deal with it.

The bank's progress also depends on decision like , how much risk should a bank take when lending money to a customer in the hope of earning substantial advisory fees.Banks also need qualified staff who can handle sophisticated financial tools, concepts and valuation techniques accessible only to the initiated, and directors must have a very solid background in the business.

Global Banking Trends:
The current global macro-economic situation is characterized by an unbalanced economic recovery across advanced and emerging economies, moderation in economic prospects in 2011, high levels of unemployment and inflationary pressures, and elevated levels of government debt (Chart II.1).

Macro-economic risks have increased substantially:
In its September 2011 World Economic Outlook, the International Monetary Fund (IMF) has estimated a growth of 4.0 per cent for the world economy as a whole during 2011, with emerging and developing economies growing at 6.4 per cent and advanced economies growing only at 1.6 per cent. The estimate for advanced economies of 1.6 per cent provided in September 2011 was lower than the estimate of 2.2 per cent provided in June 2011 in light of the lower quarterly GDP growth of leading advanced economies. The rate of unemployment in advanced economies has been little over 8 per cent in 2010 albeit with some moderation expected in 2011 as per the IMF estimates. Inflationary pressures, which had become stubborn in 2010, more so for emerging economies as a fallout of rising oil, food and commodity prices, are expected to aggravate further in 2011.

Chart II.1: Global Macro-economic Trends



Note: The rate of unemployment is not reported separately for emerging and developing economies.
Source: Calculated from World Economic Outlook database

Uncertainty about credit revival continues:
Against the macro-economic backdrop discussed in the foregoing section, banking business in some advanced economies showed signs of revival in 2010. An increase in the growth of bank credit was evident in the US, Germany and France in the first quarter of 2011 after entering into the negative growth zone after the crisis. However, there is an uncertainty about whether this credit revival would continue or not, given the picture of economic revival looking bleak in the US and now, even in Germany1. In fact, credit growth has again witnessed a slump in the second quarter of 2011 in the US. In the UK and Japan, bank credit growth, which had entered a downtrend since the beginning of 2009, has shown a recovery in 2011, but has remained in the negative zone. Other advanced economies from Europe, particularly countries with fiscal strains, namely Portugal, Spain and Italy, showed a steep fall in the growth in bank credit with no signs of revival by 2011

Return on Assets showed a moderate increase:
Apart from the pickup in credit growth, Return on Assets (ROA), an indicator of banking system's profitability and soundness, also showed a moderate increase in the US and France in 2010 (Table II.1). The ROA of US banks turned positive by 2010 after staying in the negative zone in 2008 and 2009; it showed a further increase in 2011 (March). In Russia, China and Malaysia, ROA of the banking system, which had dipped between 2008 and 2009, recovered between 2009 and 2010. In Russia and Malaysia, the trend of increase in ROA continued even in 2011 (March). The ROA of Indian banks too showed a modest rise between 2008 and 2010.

Table II.1: Return on Assets of Banks for Select Economies

Country	2007	2008	2009	2010	2011*
Advanced economies					
France	0.4	0.0	0.4	0.6	...
Germany	0.3	-0.1	0.2	…	...
Greece	1.0	0.2	-0.1	-0.6	-0.3
Italy	0.7	0.3	0.2	…	...
Japan	0.3	-0.3	0.2	0.4	...
Portugal	1.2	0.4	0.4	0.5	0.5
Spain	1.1	0.8	0.6	0.5	...
United Kingdom	0.4	-0.4	0.1	0.2	...
United States	1.2	-0.1	-0.1	0.9	1.2
Emerging and developing economies					
Russia	3.0	1.8	0.7	1.9	2.3
China	0.9	1.0	0.9	1.0	...
India	0.9	1.0	1.1	1.1	...
Malaysia	1.5	1.5	1.2	1.5	1.8
Brazil	3.4	1.5	2.4	3.2	3.3
Mexico	2.3	1.4	1.5	1.8	1.6

Source: Compiled from Financial Soundness Indicators, IMF
… Not available
* Up to the period ending March

Revival in international banking business
In 2010-11 (March), there was considerable revival in international banking business (by location of reporting banks) continuing with the trend in 2009-10. During 2008-09, international assets and liabilities of banks had contracted significantly in the aftermath of the financial crisis (Table II.2).

Table II.2: Growth in International Assets and Liabilities of Banks

Item	2007-08	2008-09	2009-10	2010-11
Total assets	26.1	-17.5	0.2	5.4
1. External assets	26.6	-17.5	0.1	5.3
Loans and deposits	28.2	-19.0	-1.0	6.7
Holdings of securities and other assets	22.1	-13.2	3.0	1.9
2. Local assets in foreign currency	22.4	-17.5	0.7	5.7
Total liabilities	26.5	-18.0	-0.7	7.1
1. External liabilities	27.4	-18.6	0.2	6.6
Loans and deposits	26.5	-21.2	-1.3	6.0
Own issues of securities and other liabilities	33.7	-2.0	7.4	9.5
2. Local liabilities in foreign currency	20.8	-14.4	-6.1	10.5

Source: Calculated from BIS, Location Banking Statistics.

In most advanced countries, the quantum of international assets and liabilities (in all currencies vis-à-vis all sectors) also showed a similar trend of increase between end-March 2010 and end-March 2011.Among advanced countries, the increase in international business was most striking for banks located in the US and UK. Even in the emerging economies, the increase in international banking business gained considerable momentum by the first quarter of 2011. Latin American banks increasingly resorted to the issuance of securities, leading to a sharp growth in the international liabilities of these banks.

Uneven decline in leverage
There was unevenness in the decline in banking sector leverage across countries after the crisis; here, the percentage of total capital (and reserves) to total assets has been taken as an indicator of leverage in the banking system. In the US, leverage in the banking system showed some moderation between 2008 and 2010. This trend for US banks continued further in the first quarter of 2011. A moderation in leverage could also be seen for UK banks between 2008 and 2010. Notwithstanding this moderation, the extent of leverage for UK banks continued to be at relatively high levels.

Deleveraging had not gained any significant momentum in the banking systems of other advanced European economies, viz., France, Germany, Portugal, Greece and Spain, treating 2008 as the reference point.

Table II.3: Capital to Risk-Weighted Assets Ratio of Banks in Select Economies

Country	2007	2008	2009	2010	2011*
Advanced economies					
France	10.2	10.5	12.4	12.3	...
Germany	12.9	13.6	14.8	16.1	16.6
Greece	11.2	9.4	11.7	11.4	12.3
Italy	10.4	10.8	12.1	12.3	...
Japan	12.3	12.4	15.8	16.7	...
Portugal	10.4	9.4	10.5	10.2	10.5
Spain	11.4	11.3	12.2	11.8	...
United Kingdom	12.6	12.9	14.8	15.9	...
United States	12.8	12.8	14.3	15.3	15.5
Emerging and developing economies					
Brazil	18.7	18.2	18.9	17.6	18.2
China	8.4	12.0	11.4	12.2	11.8
India	12.3	13.0	13.2	13.6	...
Malaysia	14.4	15.5	18.2	17.5	16.4
Mexico	15.9	15.3	16.5	16.9	16.5
Russia	15.5	16.8	20.9	18.1	17.2

Source: Compiled from Financial Soundness Indicators,IMF
… Not available
* Up to the period ending March/May

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In this milieu, the performance of the global banking system too has been characterised by a mixed bag of a few positive developments and a number of shortfalls. The positive developments have been in terms of the efforts by countries towards revamping their regulatory and supervisory architecture learning from the crisis, along with an effort to step up capital adequacy of banks. The major shortfalls, however, have been the lack of a widespread revival of the global banking activity, which could be characterised by improved credit growth, profitability and asset quality, and lower leverage.

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