ECONOMIST IMPACT

Banking in 2035: three possible futures

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About the research

This report, written by Economist Impact and sponsored by SAS, explores major forces that stand to reshape the future of banking by 2035, and presents three potential scenarios as well as challenges and opportunities facing banks between now and 2035.

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Foreword by SAS

While most banks were able to ride out the storm of the pandemic and other crises from the last few years, the challenges they still face from a societal, business and regulatory perspective are unprecedented.

To compete in a world where uncertainty is constant, and issues like sustainability, equity, equality and a sense of community have become a part of business strategy, banks must continuously adapt to stay relevant and resilient.

As we look to the future and banking's role in our global economy, it's time to ask a bigger question. What's possible when you dare to do banking better?

We believe that banking's future in a digital economy requires a strategy centered around purpose and profitability (sas.com/betterbanking). Consumers today are apt to show loyalty to businesses that align with their environmental and social values and demonstrate global responsibility. By unifying analytics with purpose in the most authentic way, banks can put customers at the heart of their business, make stronger emotional brand connections and differentiate their business for the long term.

Banks can now make faster, data-driven decisions to deliver new levels of customer service while achieving a broad and positive social impact. Traverse from transactions to trusted relationships. Approve the much-needed loan faster. Make onboarding simpler. Serve the unbanked and underbanked. Keep fraudsters out. And personalise the experience, no matter where banking is done.

SAS is pleased to sponsor this report by Economist Impact, which explores how banks can evolve their mission and business models to shape and elevate our global economy – from societies to communities to every individual. To be a champion for people and the planet, reaching a sustainable future that's built to last. And deliver on the possibility of how conscientious banking can change the world for everyone – today through 2035 and beyond.

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Introduction

Banks today find themselves buffeted by a range of forces, many of which are accelerating. Long-term trends such as climate change and demographic ageing are picking up. Shock events like the covid-19 pandemic and the war in Ukraine have destabilised markets. The direct threat posed by both fintech and big tech companies is growing. Taken together, these forces of change are causing banks to evolve business models to meet new societal expectations and engage customers in highly dynamic digital environments.

More fundamentally, the sector's rapid evolution and uncertain future pose a basic question: what is the purpose of banks? For centuries this was not up for debate: banks existed to take deposits, make loans and realise short-term profits. They will surely continue to do this—while also expanding their mission and focus. The current era may ultimately be seen as an inflection point for banks, when they began to balance a traditional short-term profit-driven model with an alternative human-centred approach that creates long-term value via greater sustainability, resilience and inclusion. The ability to be both agile and purpose-driven, as well as winning customers over with a mix of digital innovation and resonant values, will be a prized asset.

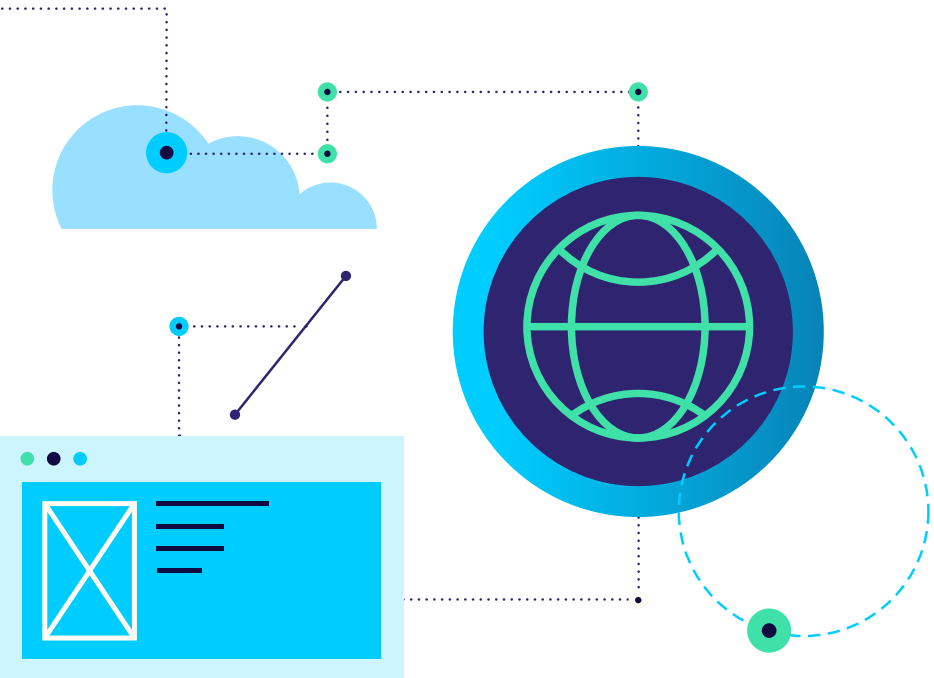
But to chart a viable course forward, banks need a clear vision of the major trends and factors reshaping their sector. They must pinpoint opportunities and risks, evolving strategy with clarity about how the forces of change challenge old assumptions and undermine their business model. Doing so, however, requires a detailed understanding of what the future might hold.

For this project, sponsored by SAS, Economist Impact conducted extensive desk research to understand the trends and themes poised to impact the future of banking. We also interviewed experts to identify current and potential challenges and opportunities. Finally, we analysed how different combinations of trends—such as digitalisation, the shift away from fossil fuels or geopolitical fragmentation—may come together to form different possible future scenarios.

This briefing paper explores how the major forces impacting banks may evolve between now and 2035. It peers into the future through three potential scenarios for the sector. Each of them is possible, depending on the course of events that unfold between now and 2035. The overarching goal is to illuminate how banks can evolve their mission and business models to deliver value to customers, shareholders, communities and the natural environment. Challenges related to the climate crisis, economic inequality, political instability and technology ethics will grow in the coming years. What can banks do to address them?

The big picture: megatrends reshaping banking

The forces shaping the future of banking are much bigger than any specific technology, event, geopolitical conflict or regulatory shift. The 2035 scenarios presented in this paper are based on megatrends: powerful forces enveloping societies, economies and sectors. Megatrends are, by definition, global, interconnected and long term. They can intersect and interact, influencing their intensity and development.



There are five megatrends particularly salient to the banking sector.

1. The digital revolution is accelerating. Digital economies built around the production, collection and protection of information (data) continue to mature. This is generating new markets and business opportunities across sectors—including banking. However, at the same time this process is intensifying regulatory and cybersecurity risks and competition as data become an essential asset and competitive differentiator.

Data proliferating with the emergence of the Internet of Things and ubiquitous networked devices will power insights and innovation. It is also likely to continue advancing the economic and social power of tech companies—raising the ire of governments. More robust regulatory regimes to rein in corporations may follow. But corporate leaders could also face heightened complexity around the globe due to fragmented data governance approaches and digital trade divided along national and commercial boundaries.

2. Economic fragmentation is gaining momentum. Globalisation is under threat in the face of rising populism, nationalism and protectionism. Instead of growing economic interdependence through cross-border trade, investment and technology, there is heightened uncertainty in global supply chains and international governance practices and agreements.

Once-powerful symbols of an inexorable global economic order such as the World Trade Organization (WTO) are losing influence as tensions between the US and China rise. A cohesive global order is fragmenting as large spheres of influence associated with these great economic powers emerge.

The decoupling of economies, seen most dramatically in the wake of Russia's invasion of Ukraine, is increasing the exposure of banks and other corporate actors to operational, financial and reputational risks. More governments are seizing on economic policy (eg, sanctions and market access) and financial instruments (eg, central bank digital currencies [CBDCs], bank accounts and foreign currency reserves) as the means for geopolitical ends. Companies are caught in the middle and increasingly forced to choose sides: neutral territory is shrinking.

3. Shared global challenges are multiplying and intensifying. Climate change is the most obvious crisis, but there are others that require co-ordinated international efforts to address.

The risk of pandemics is growing due to population growth, continued urbanisation, increased contact with animals and increased global connectivity. Humanitarian crises are rising in number and intensity due to conflicts increasingly spurred by violence involving non-state actors, anti-immigration sentiment and the effects of climate change. These challenges, as well as Russia's invasion of Ukraine in 2022, are increasing strains on the global food and energy systems. The possibility of a global food crisis is growing.

With governmental efforts to address global crises gaining steam in some areas (eg, government activism on climate action and intensified regulations on clean energy and energy efficiency) and slowing in others, private-sector actors are stepping up to play greater roles. For example, parts of the private sector are leading the transition to a low-carbon economy via a shift in investments away from fossil fuels, and increasing environment, social and governance (ESG) investing may also enable banks to better manage climate risks.

4. Efforts to combat persistent economic and social inequities face headwinds. Multiple dynamics contribute to the risk that vulnerable populations will continue to be left behind.

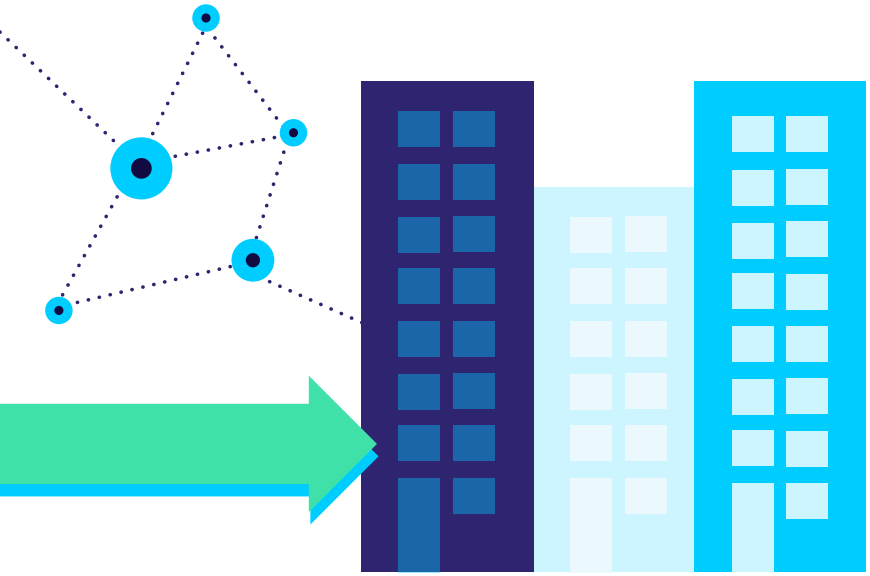
The effects of climate change disproportionately affect less developed countries and regions.[1] Digital transformation, accelerated by the covid-19 pandemic, is widening gaps within countries as well as between generations (eg, Millennials and Baby Boomers)—but it still provides an opportunity to enhance financial inclusion and eradicate poverty.[2]

Urbanisation, which concentrates both wealth and poverty, is projected to steadily rise in the coming decades, exacerbating inequalities. Groups including indigenous people and a growing number of migrants and refugees remain vulnerable to discrimination and marginalisation. Across the world, widening inequalities could contribute to an erosion of trust in financial institutions, especially among those financially excluded.

5. Ethics are moving toward the core of business practices. In the social media and activist investor age, companies including banks can now expect to be called to account for the social and environmental impact of their business.

Consumers are becoming more vocal about environmental and social issues, and often expect companies to play a role in solving these issues. Impact investing focused on generating positive social and environmental returns, along with regulatory efforts to decarbonise economies, will continue to mainstream. As digital technologies such as artificial intelligence (AI) and genomic sequencing mature, calls for "ethical technology" and regulatory scrutiny will grow. More companies may experience financial incentives tied to ethical practices.

To varying degrees, these megatrends serve as the foundation for the following 2035 scenarios. Smaller trends also informed the scenario-building process, allowing nuanced and intricate pathways towards the future to be envisioned.



[1] The Economist Intelligence Unit, "Resilience to climate change?", 2019, https://www.eiu.com/public/topical_report.aspx?campaignid=climatechange2019

[2] Qureshi, Zia, "How digital transformation is driving economic change", Brookings Institution, January 18th 2022, https://www.brookings.edu/blog/up-front/2022/01/18/how-digital-transformation-is-driving-economic-change/; Hanna, N K, "Assessing the digital economy: aims, frameworks, pilots, results, and lessons", *J Innov Entrep* 9, 16 (2020), https://innovation-entrepreneurship.springeropen.com/articles/10.1186/s13731-020-00129-1#ref-CR31

Scenario 1: transformed banks regain trust

The impact of fintech start-ups and big tech firms on the banking industry in the 2010s was mild compared with the disruption that followed. Once considered challengers, fintech and big tech companies are leading players in Europe and the US in 2035, having carved out a large share of the market by offering a superior customer experience built around trusted smartphone apps and free, frictionless mobile payments. Traditional banks have ramped up defence strategies, embracing radically different business models in a bid to survive. In 2035 banks establish and protect their reputations by proving to customers they can be trusted to protect sensitive data and offer innovative products borne of healthy market competition.

At its core, the banking industry's transformation involves wholly new business models. Traditional profit centres—interest margins and fees—have steeply eroded as digital-only banks and established tech companies reset consumer expectations. In 2035 business models built around open banking innovations are the new norm.

Banks now open their data and related insights to third parties within external data-driven innovation ecosystems. All surviving traditional banks find themselves reliant on third parties and partnerships to provide a range of valuable services and products that were once unimaginable.

These offerings are part of a ubiquitous mobile banking landscape characterised by trust, personalisation and consumer protection. In 2035 bank customers in Europe and the US make payments with a fingerprint. Banking fees have been eliminated. Cash and credit cards are obsolete. Customers also experience a frictionless, unified digital platform encompassing their entire financial life, including bank, retirement and investment accounts, credit cards and cryptocurrencies.

Customers' willingness to trust such a panoramic offering involves more than comfort with digital-first banking environments. New regulations on data privacy and cyber fraud, market integrity, competition and innovation prevented the banking sector from becoming highly consolidated while safeguarding customers' data and supporting transparency.

In 2035, banks have clear and actionable disclosure requirements, giving customers more control over their money and data.

In 2035 banks have clear and actionable disclosure requirements, giving customers more control over their money and data. Provided with access to high-quality information, consumers are now empowered to make better-informed decisions about their finances and easily decide what personal information gets shared and where it ends up.

The path to 2035

In the years leading to 2035, banks pursued partnerships with non-banking institutions, while mergers and acquisitions (M&As) accelerated the sector's digital transformation. Regulations also evolved to ensure consumer and investor protections.

The covid-19 pandemic proved an inflection point for digital transformation, and this process accelerated in the subsequent years as customers grew increasingly comfortable with fintech involving banking, investing and peer-to-peer payments. As the scale of adoption rose, so did value unlocked from new business models involving open banking, banking-as-a-service and platform banking.

As the digital transformation accelerated, banks responded with M&As and internal cultural changes. Traditional banks unable to keep up with digitalisation merged with fully digital newcomers or were acquired by larger banks. The digital transformation was also fuelled by shifts in both organisational culture and structure.

For example, senior leaders placed digitalisation at the centre of their company's strategy and eliminated silos across departments to support effective implementation. Banks ramped up hiring and training around in-demand skills, while tapping outside expertise (eg, consultants and think-tanks) to drive tech adoption forward.

While some banks already partnered with fintechs, after 2022 they increasingly cultivated partnerships with non-banking institutions to provide customers with digital ecosystem experiences. As customers interacted more deeply with these ecosystems, companies were better able to understand their preferences and behaviour, giving customers access to more personalised services related to various aspects of their lives.

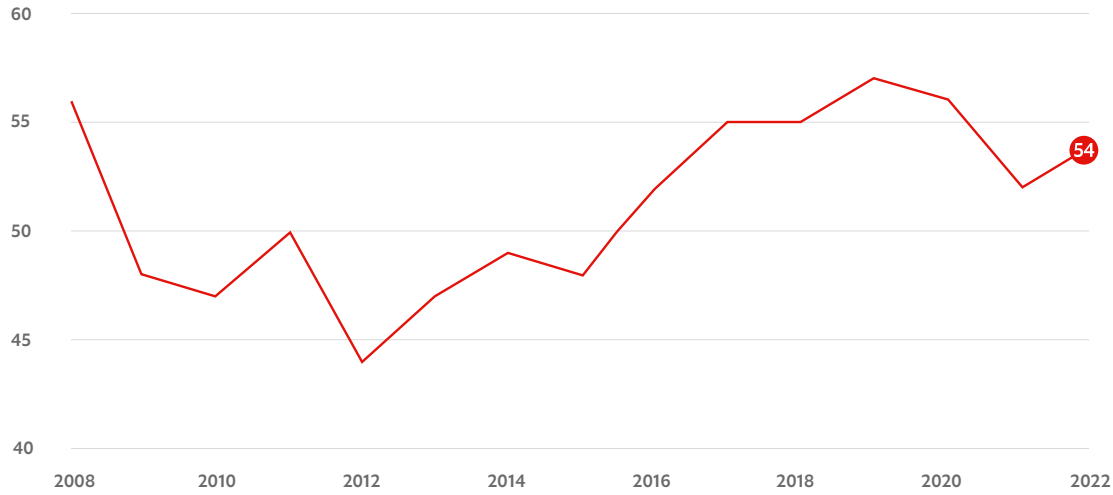
As banks became more digitalised and enmeshed with third-party service providers, they also needed to protect against heightened security threats to ensure stability and build customers' trust. Technology and data allowed banks to provide a more personalised customer experience, while AI reduced the cost of products and services via automation.

Low levels of public trust in largely unregulated technology companies initially created a backlash among consumers concerned about data privacy issues. To earn the trust of sceptical customers, big tech and banks partnered to advocate for stricter regulations on consumer and investor protections in the EU and the US. Enhanced regulations allowed for increased use of technologies in the financial services industry.

As banks built back trust with both governments and the public, these stakeholders were more confident that banks would safeguard their interests due to enhanced transparency and inclusive engagement. Civil society, watchdogs, banks, tech companies and regulators were all involved in strengthening regulations, which ensured they were widely viewed as legitimate and trustworthy.

Figure 1. Financial services has been among the least trusted sectors ranked by the public since 2008. Despite some improvement over the past decade, as at 2022 only 54% of the general population trust the sector.

Percentage of global survey respondents who trust the financial services industry, 2008-22



Note: Data for the years 2008-10 measured trust in banks.
Sources: 2009, 2010, 2011, and 2022 Edelman Trust Barometer reports.

Managing rapid change: challenges and opportunities

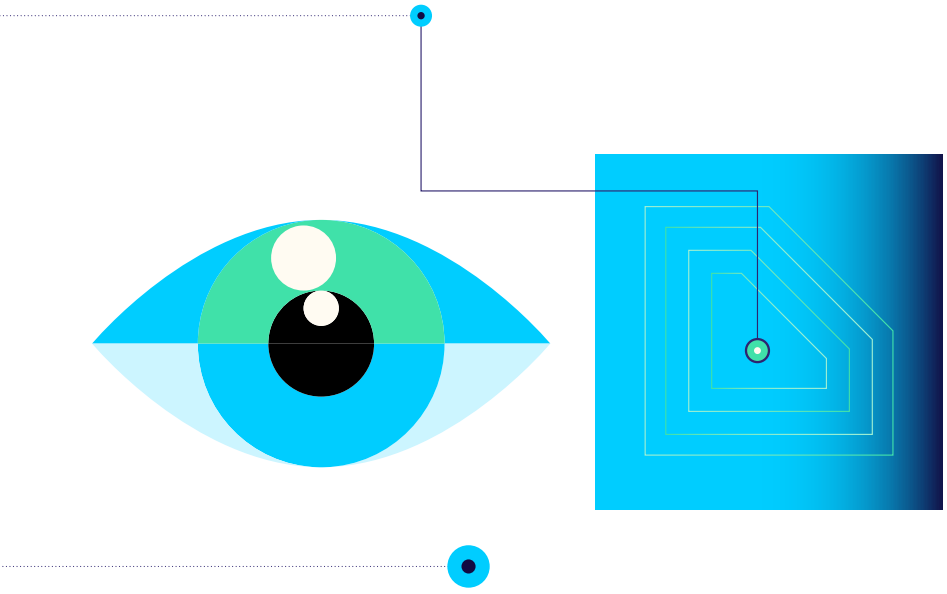
Considerable risks, both negative and positive, lie ahead for banks in this scenario. But challenges can be overcome and opportunities seized with the right mix of actions and investments.

Challenges

Updating legacy systems. This will be required as banks adopt new business models. The risk of inaction is nothing less than fading competitiveness and, ultimately, market obsolescence. Rapid modernisation of systems will likely involve new governance structures and external partnerships. Investments in new technology could extend to cybersecurity resources that mitigate threats relative to migration to new systems.

Downsides of AI. Deep adoption of AI by the banking sector will generate significant productivity—while putting tens of thousands of jobs at risk of elimination. Moreover, depending on how it is implemented, AI has the potential to perpetuate discrimination and exclusion due to the biases held by its developers. To avoid these downsides, banks could upskill employees to prepare them for the AI future and enhance diversity and inclusion efforts across the organisation so the workforce is both more reflective of the general population and aware of cognitive biases.

Re-establishing trust. More than a decade after the 2008-09 global financial crisis, banks remain among the least trusted sectors. Although the public's trust of financial services has risen since 2012, there is still a long way to go.[3] Further progress could hinge on both internal and external actions. Banks could more proactively identify and prioritise customers' needs. They could partner with governments and civil society organisations to develop new regulatory frameworks for the sector. And they could promote greater transparency about the owners of legal entities to combat money laundering and fraud.



[3] Edelman, "2021 Edelman Trust Barometer", 2021, https://www.edelman.com/trust/2021-trust-barometer

Opportunities

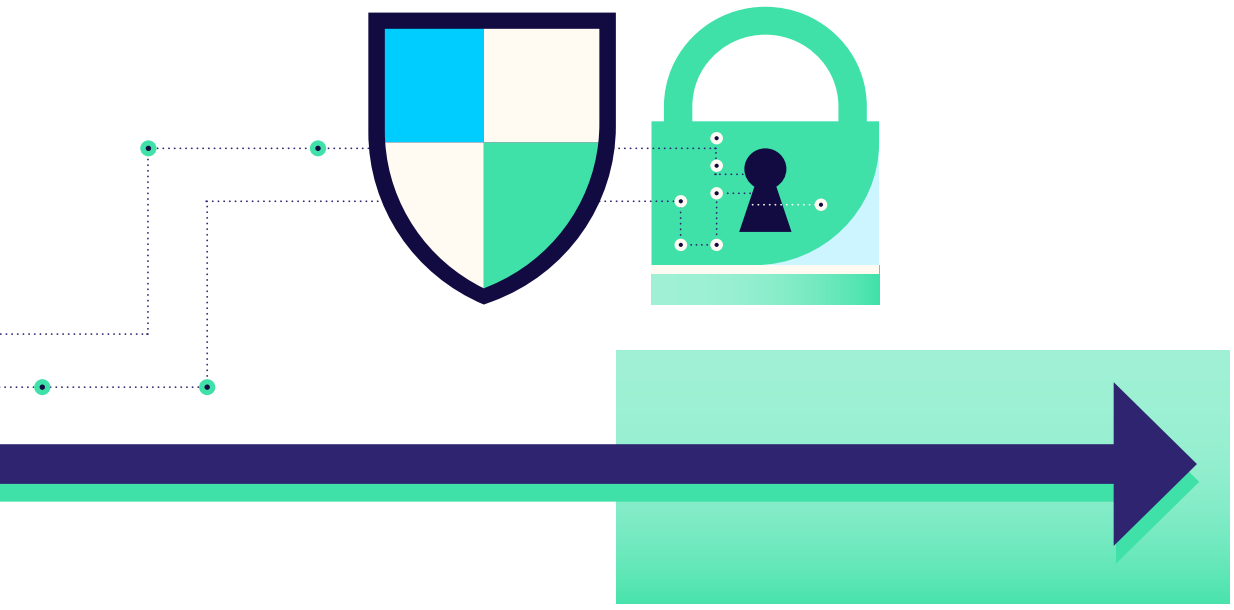
Making services more equitable and accessible. Lower costs for digital banking services could be a boon for previously unbanked segments of the population, such as indigenous people, migrants and youth, as well as ethnic and racial minorities. Banks could fine-tune credit assessments and tailor new financial products for customers once thought too risky. Widened access to credit and digital services and tools could also increase banks' revenue.

Seizing data-driven benefits. Technology and data could unlock a range of benefits extending to customers and compliance. The cost of complying with Anti-Money Laundering/ Countering the Financing of Terrorism regulations could be reduced through more efficient transaction monitoring and screening. The customer experience could be improved through increased personalisation and customisation.

Unlocking new business models. Digital transformation will reveal new business models that reimagine what banks are. Platform banking, for example, will draw in more customers and create opportunities for partnerships with a wide range of organisations. Banks could develop platforms offering customers a broader range of products and services: mortgage loans and homeowner insurance, but also home maintenance services and even furniture.

"Banks could facilitate access to financial services for unbanked populations, and could thus play a crucial role in lifting people out of poverty and breaking the cycle of inequality."

Lena Simet, senior researcher, Human Rights Watch



Scenario 2: climate action paradigm shift

After decades of division and delays among major powers on the climate crisis, substantial collective action occurs in 2035. The world is on track to limit global warming to 1.5°C above pre-industrial levels by the end of the century, preventing the most catastrophic effects of climate change. Substantial adjustments to the ways that individuals live and interact, and how businesses operate, made this climate transition possible. The digital revolution that began transforming the nature of communities, connectivity and work decades earlier is helping societies reach climate goals.

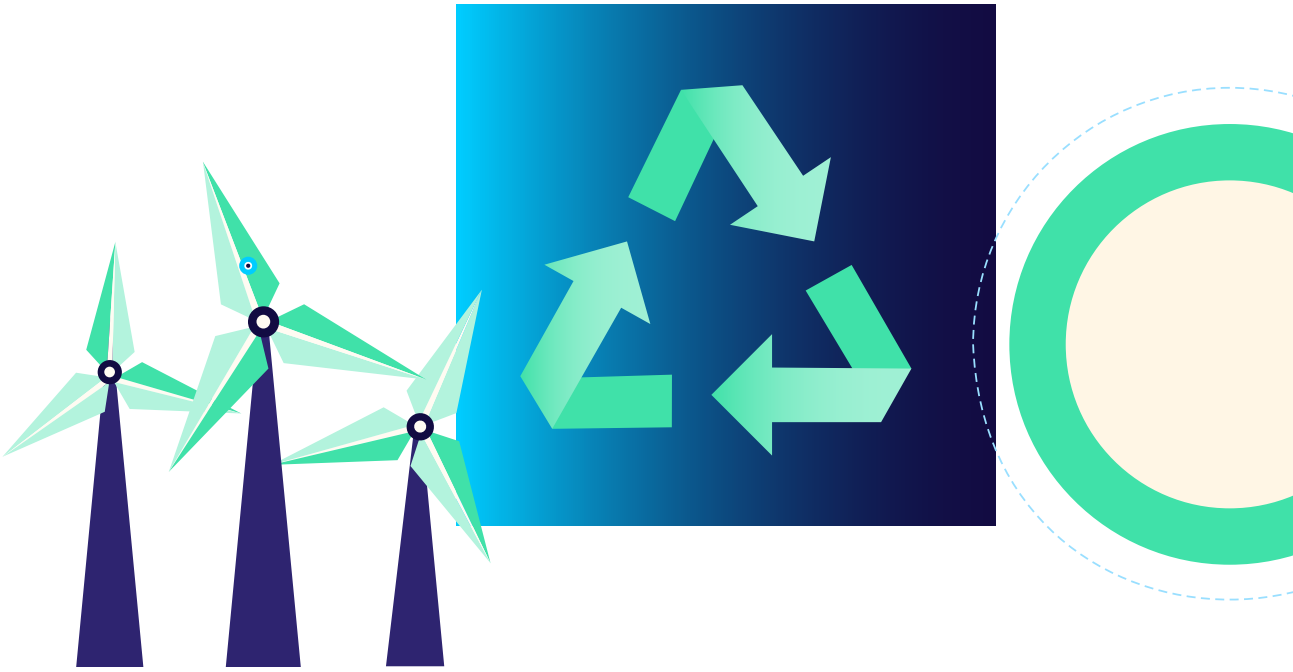
On a variety of key fronts—infrastructure, transport and energy—decarbonisation is taking hold. Major urban areas around the world have been reimagined with energy-efficiency and climate-resiliency top of mind. Old structures have been retrofitted to maximise energy savings, along with higher standards for new buildings. A decade of targeted public and private infrastructure investments have made roads, bridges, airports and ports far more resilient, while water management systems have been overhauled to ensure sustainable service.

The world is on track to limit global warming to 1.5°C above pre-industrial levels by the end of the century, preventing the most catastrophic effects of climate change.

Carbon-intensive commutes bringing workers into city offices every day are no longer typical, replaced by the hybrid work model normalised by the covid-19 pandemic. Public transport options, including electric buses and subways, are widely accessible, while sales of internal combustion engine vehicles in advanced and some emerging economies are now banned. With fast-charging electric vehicle stations now commonplace, half the vehicles on the road are all-electric or hybrid.

Additionally, some airlines have already left jet fuels behind, dramatically reducing passengers' carbon footprints. Zero-emission commercial aircrafts are now in service, relying on hydrogen fuel produced via renewable energy.[4]

[4] Airbus, "Airbus reveals new zero-emission concept aircraft", September 21st 2020, https://www.airbus.com/en/newsroom/press-releases/2020-09-airbus-reveals-new-zero-emission-concept-aircraft



Renewable energy sources and technologies have transformed how electricity is produced and distributed. Nearly all households in major urban areas around the world are now equipped with advanced metering and energy management systems, running highly efficient smart appliances. In advanced economies, fossil fuel-based power plants have been shuttered in favour of electricity produced exclusively from the sun, wind and other renewable sources, including a burgeoning global green hydrogen market. Rural households in Sub-Saharan Africa and South Asia now enjoy near-universal energy access, largely driven by the spread of off-grid renewable energy.

Growing global digital connections and climate crisis awareness are also powering the paradigm shift. Communities and colleagues are now so closely connected across continents and borders that business travel has sharply declined. Many consumers consciously avoid air travel to reduce their carbon footprints; others cut back personal travel after high fuel costs ended the days of cheap airfares. Digital currencies are now mainstream in advanced and emerging economies, and cryptocurrency mining has become energy efficient at scale.

The path to 2035

The key to catalysing truly global climate action in the years leading up to 2035 was consumer and investor pressure, new rules, policies and regulations, and technological breakthroughs.

ESG investing accelerated as consumer demand mounted. At the same time, institutional investors rapidly shifted away from carbon-intensive industries, voting with their dollars for a rapid transition to a low-carbon economy.

A major step forward was mandated ESG reporting for both large corporations and small and medium-sized enterprises. Regulators in Asia, Europe and the US established a common standard of reporting after sustained investor campaigns, resulting in high-quality and more comparable ESG data to understand companies' climate change risk management.

"Solid ESG data will allow banks to improve how they price climate risks and then allocate capital accordingly. Right now, banks and investors are in the dark relative to their exposure and a particular company's exposure to climate-related risks."

Tobias Adrian, financial counsellor and director, Monetary and Capital Markets Department, International Monetary Fund

With better ESG data acting as a foundation for change, portfolios began aligning with goals set forth by climate scientists and international accords such as the Paris Agreement. Fearful of abandonment by investors and lacking climate risk assessment and transition expertise, companies started partnering with outside organisations such as the Net-Zero Banking Alliance to improve data collection and reporting capabilities and comply with ESG regulations. With ESG performance correlating to higher returns for investors and improved long-term financial performance, businesses embraced actions to mitigate climate risks.

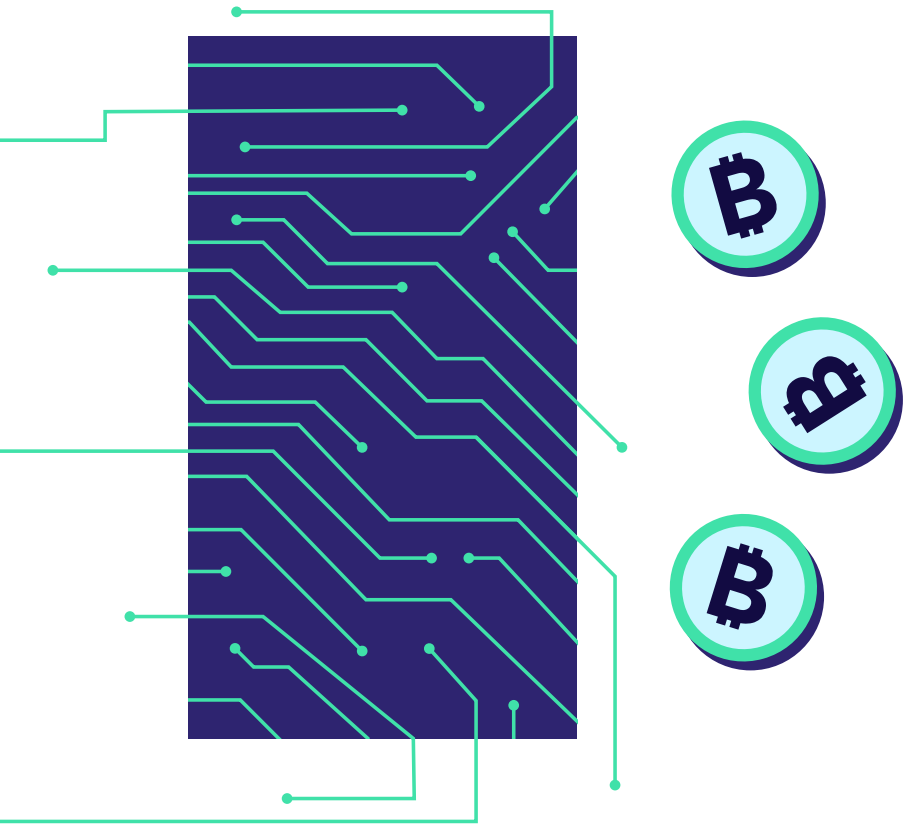
The transition to a low-carbon economy was also accelerated by the introduction of a carbon tax by the planet's major polluters. The EU's Carbon Border Adjustment Mechanism (CBAM) came into effect, requiring both EU-based and foreign companies to pay a carbon tax when selling goods and services in the EU market. Industries subsequently reduced carbon emissions via cleaner energy sources and more energy-efficient processes.

In response to the CBAM, China, India and the US collectively set a carbon price floor of US$35 per ton of carbon emitted to remain competitive.[5] Carbon taxes incentivised advanced economies to phase out coal production by 2035; emerging economies followed suit by 2040.[6] Revenue from these taxes were invested in research and development (R&D) promoting green technologies.

[5] IMF, "Proposal for an international carbon price floor among large emitters", June 18th 2021

[6] Claire Fyson, "Coal phase out", Climate Analytics, accessed on April 22nd 2022, https://climateanalytics.org/briefings/coal-phase-out/

Technological breakthroughs powered by public-private partnerships proved consequential. Governments invested in early stage R&D, while banks, venture capitalists and other financial institutions provided capital to scale up and mature cutting-edge renewable technologies.



The emergence of advanced batteries for use by both consumers and electricity providers was a crucial driver of the adoption of renewable energies at scale. Long-storage batteries helped stabilise the electricity grid at night and during variable weather and climate conditions. This allowed major advanced economies to reach targets to produce electricity exclusively from renewable sources.

The cost of solar and wind power infrastructure continued to decrease, allowing large-scale utilities projects to take off, especially in countries with high renewable energy potential like Saudi Arabia and Mexico. Fast adoption of new technologies (eg, solar and electric vehicles) by consumers was equally important for the climate transition.

Finally, the growing energy consumption needed to mine cryptocurrencies, which continued to increase in popularity, threatened to push the world beyond the 1.5°C threshold. But consumers successfully pushed the crypto community to adopt software code that made mining far more efficient, eliminating the bulk of cryptocurrencies' energy requirements.[7]

[7] Tyler Kruse, "Change The Code: Not The Climate", Greenpeace, March 29th 2022

Capitalism for the climate: challenges and opportunities

Global markets' shift away from fossil fuels and toward climate resilience represent a historic moment of transformation for capitalism. As a linchpin of the economic system, banks could be at the forefront of change. The coming years will present banks with both challenges to overcome and opportunities to capture.

Global markets' shift away from fossil fuels and toward climate resilience represent a historic moment of transformation for capitalism. As a linchpin of the economic system, banks could be at the forefront of change.

Challenges

Internal culture change. In response to growing pressure from investors, banks will have to integrate ESG into the core of their strategies and decarbonise. This will be highly dependent on senior leaders driving cultural change throughout organisations. To do this, banks could incentivise both executives and employees to implement ESG-related practices and policies. What once might have been the province of the sustainability department should become a standard operating procedure across the organisation.

Short-term/long-term tradeoffs. In the short term, carbon-intensive industries will continue to be profitable, making divestment difficult. But the window to secure a green transition in the long term is rapidly closing. Thus, it is imperative that banks set long-term objectives on climate action, creating a clear framework for moving away from fossil fuels in the short term. This necessarily involves a better understanding of climate risk.

Opportunities

Managing climate risks. Wide availability of ESG data will allow banks to better forecast and manage climate risks, ranging from the physical damage caused by extreme weather to the ability of businesses reliant on fossil fuels to transition to a low-carbon economy.

Financing the transition. With support from multilateral organisations, governments and philanthropy, the banking industry will find new financing opportunities to help power the green transition. Greater climate action by governments and public investments in R&D could set the stage for private financing to commercially develop and mainstream decarbonisation technologies.[8]

[8] PwC, "State of climate tech 2021: scaling breakthroughs for net net zero", 2021, https://www.pwc.com/gx/en/sustainability/publications/assets/pwc-state-of-climate-tech-report.pdf pdf te-tech-report.pdf

Scenario 3: a fragmented world

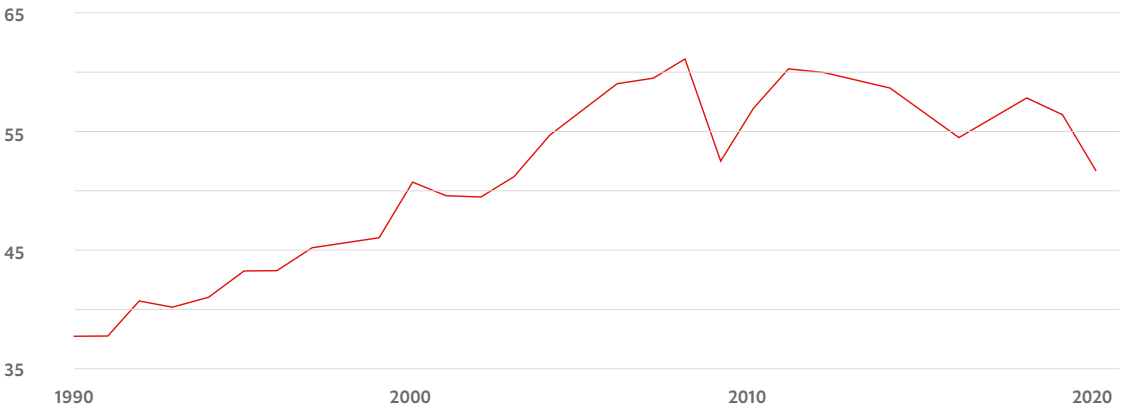
In 2035 the period of globalisation that steadily integrated markets around the world after the cold war is over. That liberal economic order has faded, fragmented by a deeply multipolar geopolitical landscape. Bilateral and regional trade agreements now dominate rather than the WTO, which was once the key forum for trade negotiations and disputes. US hegemony of the global financial system has been fractured by rivals' alternative payment systems as well as the rise of digital currencies.

Global trade in goods and services is now below 50% of GDP, from about 57% in the years leading up to the covid-19 pandemic.[9] Protectionist impulses have led regional blocs to compete on digital technology and trade policies.

Now comprising more than half of total global GDP,[10] emerging economies assert their own power and independence via strong domestic economies and enhanced regional trade and investment.

Figure 2. After two decades of growth, trade in goods and services have stagnated since the 2008-09 global financial crisis, hovering at about 57% of global GDP.

Global trade of goods and services as a share of GDP, 1990-2020



Source: World Development Indicators, World Bank

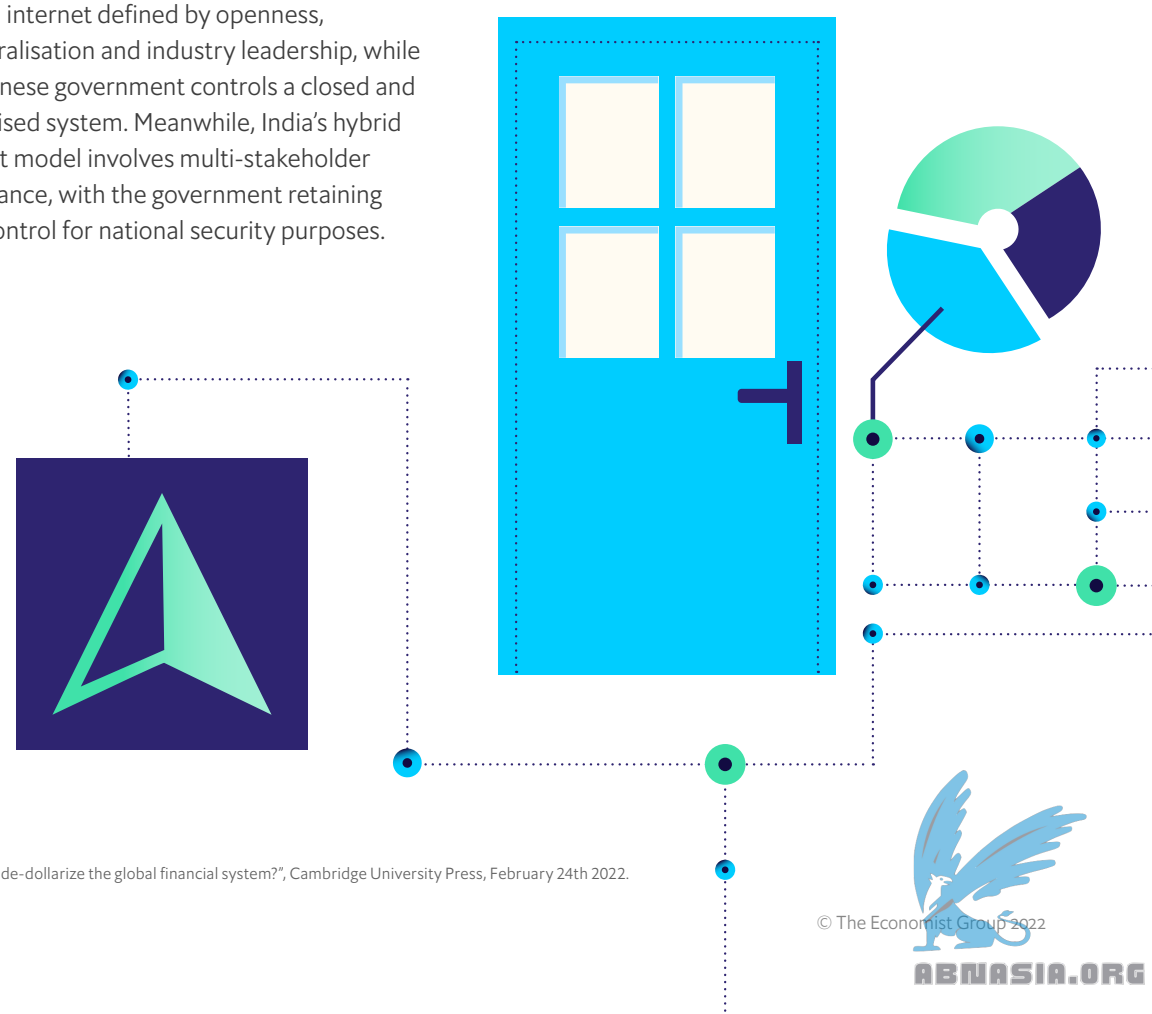
[9] The World Bank, World Development Indicators, Trade (% of GDP), accessed on April 22nd 2022, https://data.worldbank.org/indicator/NE.TRD.GNFS.ZS

[10] OECD, "Economy: Developing countries set to account for nearly 60% of world GDP by 2030, according to new estimates"

A changed global monetary system underscores the new multipolar reality. The SWIFT payment system no longer has a monopoly on financial transactions after a coalition of developing economies—led by Brazil, Russia, India, China and South Africa (BRICS+)—created an alternative system now widely integrated across the global economy.[11] The Chinese Yuan is now the third-largest currency reserve, after the US dollar and the Euro.

Superheated technology competition between the US and China is creating distinct spheres of influence. China dominates in some high-tech realms, such as AI, quantum computers and autonomous vehicles, while the US leads in core capabilities such as semiconductors and operating systems. Internet governance rules have splintered. The US and Europe host an internet defined by openness, decentralisation and industry leadership, while the Chinese government controls a closed and centralised system. Meanwhile, India's hybrid internet model involves multi-stakeholder governance, with the government retaining clear control for national security purposes.

Migration patterns have changed with global power shifts. With the Global South, led by BRICS+ countries, on the rise, South-South national co-operation has significantly strengthened, altering long-standing immigration and global talent flows. South-to-North migration rates of both immigrants and refugees have fallen. This, along with rapidly ageing populations, is intensifying developed countries' competition for talent to drive innovation. Rising nationalism in developed countries is also altering migration patterns. Many governments are opening doors for highly skilled immigrants while working to keep unskilled workers out.



[11] Zongyuan Zoe Liu and Mehaela Papa, "Can BRICS de-dollarize the global financial system?", Cambridge University Press, February 24th 2022.

The path to 2035

In the years leading up to 2035, continued global fragmentation accelerated competition and regionalism, and BRICS+ countries continued rising as formidable economic and political powers. Digital transformation intensified the backlash against globalisation due to fears of widening inequalities and job displacement.

Global fragmentation began mounting in the years following the covid-19 pandemic as the EU, the US and China protected their respective, divergent interests rather than co-operating via multilateral trade. Many advanced economies reshored key manufacturing industries (such as semiconductors and aerospace) to serve national interests. Global trade levels steadily declined.

With US-China disagreements over investor and intellectual property rights falling outside the WTO's purview, the US increasingly turned to unilateral and plurilateral measures such as sanctions and export restrictions. China's protectionist policies enabled its largest technology firms to become competitive with Europe and the US. As the Chinese economy matured, however, it became less reliant on foreign trade and therefore more retracted from other nations.

Meanwhile, even as the EU strove to establish global standards for AI ethics and blockchain technology, it installed protectionist trade policies that temporarily positioned its market as a competitor to the US.

After a period of tension between the EU and the US, the Transatlantic Trade and Investment Partnership was revived, reducing non-trade barriers between the two blocs, while setting regional standards on emerging technologies (eg, AI, semiconductors and data governance). Trade agreements became as much based on common political interests as economic interests.

"More and more trade in the future will be related to foreign policy constraints and objectives, not markets functioning well. The covid-19 pandemic and the Russia-Ukraine international crisis—especially the latter—are catalysing this trend."

Sébastien Miroudot, senior trade policy analyst, OECD

As 2035 approached, new trade agreements were formed between like-minded BRICS+ countries such as Turkey, Egypt and Indonesia. Agreements increasingly became tools for asserting and achieving greater geopolitical influence. Many developing nations sought to decrease their dependence on the US by enhancing trade relations and economic integration with Asia, especially China. Agreements similar to Asia-Pacific's Regional Comprehensive Economic Partnership multiplied.

With their economic and political power rising, BRICS+ countries pushed to reduce the reliance of the global economy on the US dollar for two reasons. First, they wanted to reduce currency and sanction risks. Second, they wished to diversify the monetary and financial system to protect themselves against future financial crises centred on advanced economies.

The end of the US dollar dominance was aided by maturing digital technologies such as blockchain, digital currencies and cloud-based financial infrastructure.[12] A new payment system, which incorporated CBDCs to enable faster and cheaper transactions, emerged as an alternative to SWIFT. It also competed against non-digital- and crypto-currencies.

Finally, fears of widening inequalities and job displacement due to digital transformation continued to intensify the backlash against globalisation in advanced economies. Accordingly, firms reshored some high-value chain manufacturing (eg, automotive and electronics)[13] as AI-driven automation made many goods cheaper to produce domestically.

[12] Dion Rabouin, "The U.S. is losing the global race to decide the future of money—and it could doom the almighty dollar", TIME, September 21st 2021

[13] Joshua Meltzer, "The impact of artificial intelligence on international trade", Brookings Institution, December 13th 2018

The new multipolar order: challenges and opportunities

A new geopolitical and economic landscape defined by fragmented trading and financial systems will significantly impact the risks banks face. But opportunities will emerge relative to both digital technologies and fast-growing new markets.

Challenges

Rising intermediation costs. In a fragmented financial system, banks will be unable to achieve current economies of scale. Along with uncertainty due to trade wars and political instability, this will increase the cost of financial intermediation (eg, the difference between lending and deposit rates). Forward-looking banks could leverage technology to simplify and automate products, services and underlying processes to reduce operating costs and provide more competitive offerings.[14]

Rising reputational and cybersecurity risks. With the emergence of an alternative to SWIFT allowing countries to evade economic sanctions, political tensions will rise between and among Western and BRICS+ countries. Increased digitalisation and polarisation will also increase the risk of digital warfare. Western-based banks will face both heightened reputational and cybersecurity risks in this environment. To succeed, they could strengthen capabilities around risk analysis and mitigation, and crisis management.[15]

Opportunities

Maturation of digital currencies. As regulations de-risk digital currencies, pushing consumer demand higher, banks will have the opportunity to become more efficient and innovative. Digital currencies could allow established organisations to offer cheaper and faster services,[16] becoming more competitive with fintech challengers. On the other hand, banks could lose potential customers with the increased adoption of CBDCs, which would allow customers to pay and save in government-provided digital wallets without entering the banking system.

New customer pipelines. Shifts in trade flows in Africa and Asia, in part spurred by regional co-operation on trade and investments, will present banks with new market opportunities. As they look to serve more customers in these regions, banks could assess risks across multiple dimensions: credit, compliance, reputation and foreign exchange. They could also win new customers by stepping up to finance local development projects.

"For many major retail banks, emerging markets represent a big opportunity. North America is quite saturated while Europe is cautiously regulated. Asia-Pacific and Africa, with a growing middle-class, are therefore becoming the main avenue for new markets and customers."

Suha Gillani, ESG & Sustainability manager, Grant Thornton

[14] Sean Campbell, "When bigger is beneficial: Scale economies in the banking industry", Financial Services Forum, August 16th 2018; Ben Bernanke, "Ending "too big to fail": What's the right approach?", Brookings Institution, May 13th 2016

[15] Condoleezza Rice and Amy Zegart, "Managing 21st century political risk", Harvard Business Review, May-June 2018

[16] Gabriel Soderberg et al, "Behind the scenes of central bank digital currency: Emerging trends, insights, and policy lessons", IMF, February 2022

One certainty amid a range of possibilities

It is entirely possible that tech companies will not have taken over the banking sector by 2035. Progress on climate change may have stalled. US hegemony of the global financial system could remain intact. But apart from the three specific scenarios presented here, the megatrends that will shape the future of banking in the coming years leave little room for doubt: massive changes are on the horizon. New technologies, new consumer expectations and a range of new risks will force banks to think and act in different ways. They will be forced to stake out new ground strategically, technologically and ethically.

But banks must do more than merely react to customer demands, competitive threats and geopolitical events. As an essential element of the global order, the sector is well positioned to drive progress on multiple fronts. For example, digital banking services on near-ubiquitous mobile devices could extend the benefits of credit and other financial services to previously unbanked people, addressing inequality. Better ESG data could facilitate the transition to a low-carbon economy.

The question is: how boldly will banks embrace change and a broader ethic to address growing economic, social and environmental instability? Put another way: to what extent will banks be willing to reimagine themselves for the 21st century? The coming years will offer answers.

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