

THE ASSOCIATION OF SOUTHEAST ASIAN NATIONS (ASEAN) IS PRIMED FOR THE BENEFITS OF GREATER BANKING INTEGRATION.

NOW IT IS UP TO BANKS TO CHOOSE THEIR COURSE FOR NAVIGATING THE EMERGING TRENDS IN THIS FAST PACED REGION.

## ASEAN¹ IS CAPTURING THE WORLD'S ATTENTION AS A KEY MANUFACTURING HUB AND EMERGING ENGINE OF GROWTH.

Many had expected the region's trade integration to falter during the Global Financial Crisis (GFC) amid falling export demand from the developed world, investor exits, and retreat from some large trade financier European banks. However, ASEAN defied the detractors and proved a resilient base for a new cohort of international banks.

Now, with trade integration well advanced and the path set for financial integration, ASEAN is increasingly relevant in a regional and global context. Therefore, regardless of where in the world a bank may be based, it is important to have a clearly articulated approach to member countries. In ANZ's in-region experience, there are three broad approaches a bank may take to the region, depending on presence, client base and strategy:

- Regional Banks are local champion banks defined in this paper as having seven or more points of presence across ASEAN. These banks have deep investment in the region and the capital permanency to weather intermittent political and social upheaval, creation and destruction of bubbles, a changing competitive landscape and tougher regulation across developing markets in ASEAN. Some examples of Regional Banks include Bangkok Bank (BBL), United Overseas Bank (UOB), Malayan Banking Berhad (Maybank), HSBC and Standard Chartered Bank. ANZ also identifies as a regional bank.
- Network Banks typically look to match their onshore presence in ASEAN countries to the major centres of their customers' operations, therein providing end-to-end service across major trade corridors. Often these banks have a strong presence across some or all ASEAN 5 countries (Singapore, Malaysia, Philippines, Indonesia and Thailand), but use alliances or partnerships to support customers in ASEAN countries with lower volumes. Some examples of Network Banks include Bank of Communications, Krung Thai Bank and Siam Commercial Bank.

• Partnership Banks comprise the largest grouping, focusing on strong domestic services to local companies in home markets, including cash management and foreign exchange. As their local corporate customers expand presence beyond domestic borders and into Asia, Partnership Banks need a network of banks that can support their customers' increasingly complex off-shore requirements. Some examples of Partnership Banks include Wells Fargo, Lloyds and BDO Unibank.

Each of the approaches will likely need to adapt as ASEAN evolves. In this paper, ANZ characterises the three banking approaches across developing ASEAN sub-regions, the High Income Economies; the Mid Manufacturing Competitors; and the Mekong Frontier. We then share our observations of three long-term trends that may not be immediately apparent to banks outside the region:

- The growing importance of the Mekong Frontier to multinational corporations (MNCs);
- The proliferation of bilateral trade agreements across ASEAN nations and key trading countries; and
- The de-dollarisation and rise of intra-ASEAN direct foreign currency pairs.

ANZ is a strong believer in the ASEAN bloc and while we expect to see increasing competition in cash management, hedging products, trade and services, it is an exciting time to operate in the region and take part in the dynamic growth story. There is no one-size-fits-all approach to ensure success of a bank in ASEAN, but banks that stay mindful of local changes and adapt their position will be better placed to capture the many opportunities ASEAN promises.

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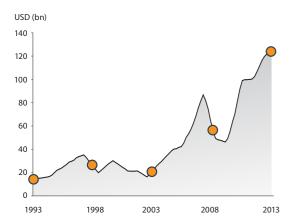
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### A COMPELLING GROWTH STORY AUGMENTED BY INCREASING INTEGRATION

ASEAN's growth story is compelling, but it is the region's commitment to free trade and progressive integration that is spurring much of the investment surge evidenced in the last 5 years (Figure 1). The imminent ASEAN Economic Community (AEC) launch and newly minted ASEAN Banking Integration Framework (ABIF) bring together ten growth economies overcoming cultural, regulatory and even language barriers to create a unified USD2.5trn² economy and regional financial market comparable in size to Brazil, India

and the combined Gulf Cooperation Council countries (Figure 2). While the growth profile of the individual countries within ASEAN will vary greatly, all members except for Brunei are expected to chart a comfortable trajectory upwards such that, by 2025 ASEAN will be a ~USD4.5trn economy<sup>3</sup>.

FIGURE 1: FDI Inflows Into ASEAN



Source: Haver, WITS, CEIC, UNCTAD, ANZ Research

FIGURE 2: GDP of ASEAN vs. Other Comparable Economies



Source: IMF's World Economic Outlook Database, April 2015

Notes: ASEAN – Association of Southeast Asian Nations, AUS – Australia, BRA – Brazil, CHN – China, FRA – France, GBR – United Kingdom, GCC – Gulf Cooperation Council, IND – India, JPN – Japan, KOR – South Korea

#### Footnotes

2. Gross Domestic Product, current prices (US Dollars), 2015 sourced from IMF's World Economic Outlook Database, April 2015 and Control of Co

3. ASEAN – The Next Horizon, ANZ Research In Depth Series (April, 2015)



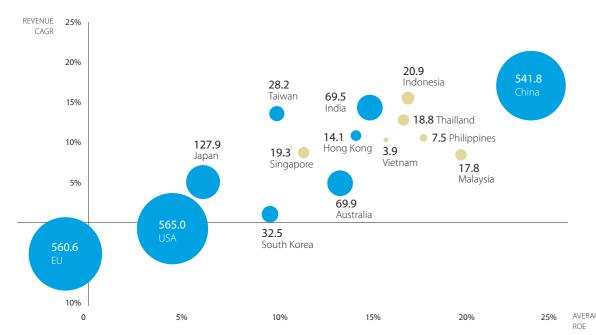
## THREE BANKING APPROACHES HAVE EMERGED TO CAPTURE ASEAN'S OPPORTUNITIES

Many banks, ANZ included, have responded to the AEC and its promise of greater regional integration. As shown in Figures 3<sup>4</sup> and 4, ASEAN member country banking return on equity, asset and revenue growth over the last 5 years represent a compelling investment case, especially when taken together with Greater China and India. But while banking prospects are bright, operational challenges abound too and there is no singular consensus as to which banks will emerge as winners and losers in the region.

**Regional Banks** indigenous to ASEAN, or the broader Asia Pacific region, have largely taken over from those US and European based rivals who have retreated to their home markets. These Regional Banks had relatively limited and manageable exposures to the key drivers of the GFC. This represented a distinct comparative advantage in their financial wherewithal with respect to Asia's growth opportunities and challenges.

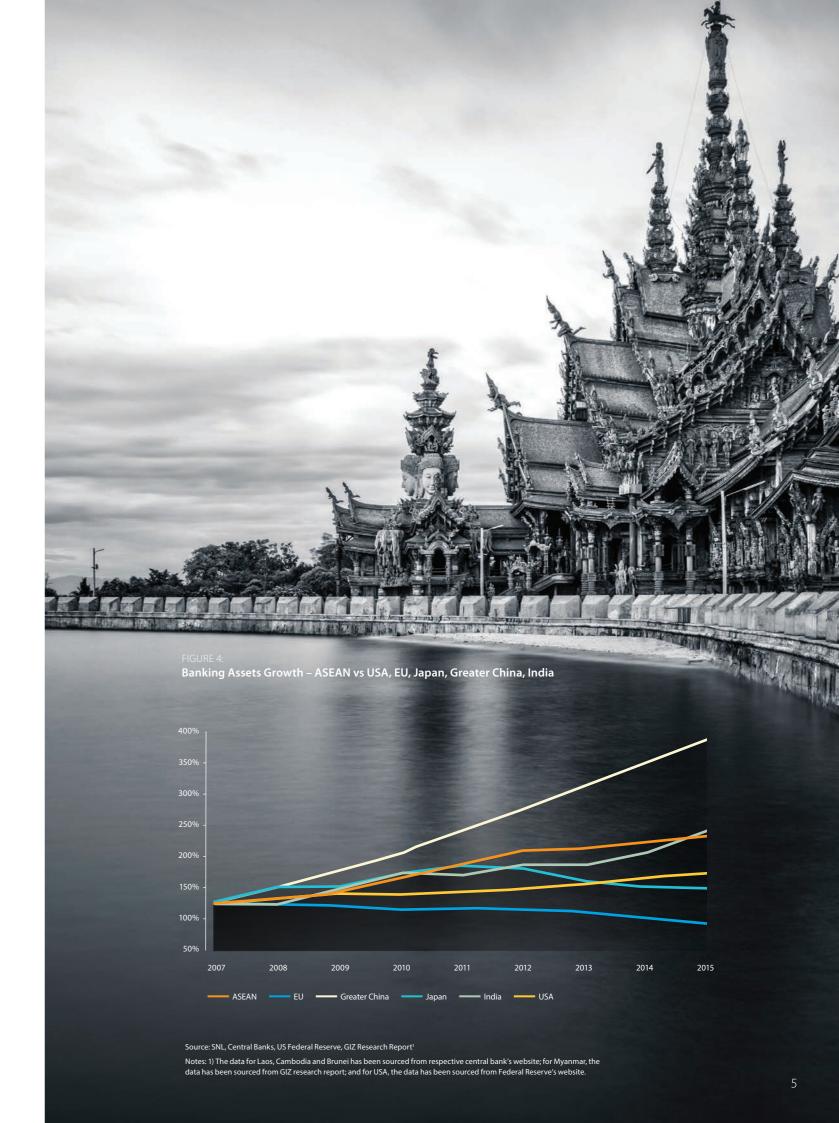
ANZ stocktake on banks with over seven branch or subsidiary points of presence identified fourteen Regional Banks. Along with ANZ, this included the usual suspects from Europe, China and Japan. Unsurprisingly, indigenous ASEAN banks were also well represented, although the skew is far weighted to Singapore and Malaysian banks.

FIGURE 3: **ASEAN Banking ROE vs Revenue Size/Trend 2010-14**Size of the Bubble represents Total Revenue (USD bn)



Source: SNL

4. Note that this includes SNL coverage banks only. Data for Cambodia, Laos and Myanmar banking systems was unavailable



#### BANKING APPROACHES



\$2.5
USD TRILLION
ASEAN GDP Value

\$843

ASEAN's largest banking sector, Singapore

<\$9 USD BILLION

ASEAN's smallest banking sector, Laos

## FOR MANY HIGH-GROWTH ASEAN MARKETS, DOMESTICALLY FOCUSED BANKS CAN ACHIEVE HIGHER RETURNS RE-INVESTING ORGANIC GROWTH PROCEEDS IN THE HOME MARKET...

**Network Banks** recognise the advantages, from both a wallet and relationship perspective, of end-to-end banking services for their customers, but are more selective or have less financial capacity to deploy resources in an onshore banking operation. These banks typically look to match their onshore presence in ASEAN countries to the major centres of their customers' operations in Asia, supporting customers outside of these major centres via partnerships. With many multi-national corporations (MNCs) leveraging business-friendly Singapore as a regional headquarter (RHQ), Network Banks usually maintain a Singapore branch at the very least. Singapore onshore operations allow Network Banks to capture payments and trade flows between their MNC customers' Singapore headquarters and their home country in the US, Europe or elsewhere in Asia.

That almost all Regional and Network Banks have a Singapore branch or subsidiary is not a surprise given Singapore's consistent top polling in ease of doing business surveys. However, one of the most interesting observations is that Vietnam stands out as the second most popular country for Regional and Network Banks in ASEAN. Vietnam falls outside the ASEAN 5 countries, which are intuitively more conducive to commercial banking. ANZ itself has extensive Vietnam subsidiary operations and is a strong believer in the country's strong economic promise due to a large, youthful population. However, other reasons for Vietnam as the second favoured ASEAN country opportunity for Regional and Network Banks may be relatively low capital costs of entry without the strong major local banks of the ASEAN 5 countries.

International or regional expansion is not the right strategy for all banks. **Partnership Banks** collaborate with other banks to support their customers' offshore strategies. For many high-growth ASEAN markets, domestically focused banks can achieve higher returns re-investing organic growth proceeds in the home market, and riding the economic development and financial inclusion wave via scale and local differentiation. Likewise, for banks domiciled outside the ASEAN bloc with no onshore presence, the region is now sufficiently banked that the incremental cost for establishing new onshore operations is unlikely to achieve adequate return on investment.

To retain their home-market advantage, Partnership Banks, typically choose partner banks that support their clients' international footprints and strategies, but do not impinge on their home market. Collaboration opportunities can range from bilateral, single product relationships to multilateral, multi-market endeavours. However, ANZ increasingly sees Partnership Banks choosing fewer, more meaningful partnerships with Regional Banks rather than spreading the business across multiple partners.

## THREE SUB-REGIONS ARE RISING IN LINE WITH ASEAN TRADE AND FINANCIAL INTEGRATION

ASEAN has come a long way in terms of trade integration with solid intra-regional trade growth over the past decade reaching USD609bn<sup>5</sup> in 2013. While there are cyclical factors lowering the pace of trade growth, ANZ Research still expect over USD1trn in intra ASEAN trade by 2025 (Figure 5).

Indeed, progress on trade integration has been commendable with almost all goods traded within ASEAN now at zero tariff<sup>6</sup>.

However, there has been far less to boast for ASEAN financial integration to date. One of the biggest challenges has been the complexity of local markets, with member countries differing substantially in terms of consumer preferences, social behaviour, politics, religions, regulations, competition and sheer scale – as shown in Figure 6, Singapore's banking sector at USD843bn is almost 100 times the size of Laos' banking sector at USD8.6bn.

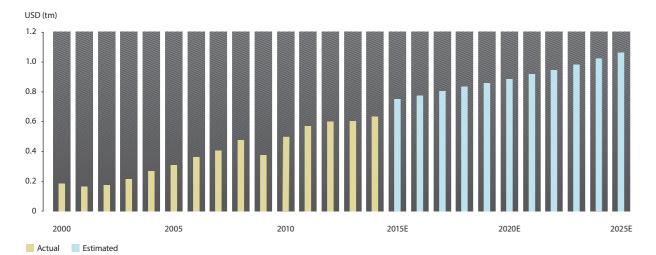
These cross-border differences require local customisation of banking operations which dilutes some of the benefits and synergies of regional business. While more pronounced in the banking sector, the lack of consistency between markets is also evident in less regulated sectors, with ANZ Research<sup>7</sup> foreshadowing the emergence of three sub-regions:

- 1. **The High Income Economies:** Singapore, Brunei and Malaysia;
- 2. **The Mid Manufacturing Competitors:** Thailand, Vietnam, Indonesia and the Philippines; and
- 3. The Mekong Frontier: Myanmar, Cambodia and Laos;

With the exception of Brunei, whose banking sector is less developed, these sub-regions broadly reflect banking sector advancement and capital markets depth. Given the banking sector's dominance in ASEAN financial intermediation, strong bank partnerships that span thought leadership and the collaborative provision of cash management, trade, foreign currency and liquidity are essential to deeper regional integration and enhancing ASEAN growth potential.

The existing regulatory barriers favour banks with a committed strategy, long term plan for the region and strong balance sheet to weather intermittent headwinds and support future sustainable asset growth. However, the differentiated impact of integration could create new winners and losers among Regional, Network and Partnership Banks alike. Until financial integration begins in earnest, banks operating in ASEAN may need to think 'out of the box' to get things done.

### FIGURE 5: Intra ASEAN Trade



 $Source: {\tt UNCTAD}, {\tt WITS}, {\tt ADB}, {\tt CEIC}, {\tt ANZ} \ {\tt Research}$ 

 $5.\,\mathsf{ASEAN}\,\mathsf{Statistics},\mathsf{Intra-ASEAN}\,\mathsf{Trade}\,\mathsf{2013}$ 



<sup>6.</sup> The AEC blueprint was adopted in 2007 to achieve a free flow of goods, services, investments, and skilled people within the region by 2015. More than 90% of the key deliverables targeted for completion by 2015 have been implemented and virtually all goods traded within ASEAN are at zero tariff (source Monetary Authority of Singapore Keynote Address by Ravi Menon, June 2015) 7. ASEAN – The Next Horizon, ANZ Research In Depth Series (April, 2015)



THAILAND ASPIRES TO EMULATE SINGAPORE AS A TRADING HUB, AND IS EMERGING AS ASEAN'S LOGISTICS CENTRE FOR COMPANIES' EXPANSION INTO VIETNAM, CAMBODIA, MYANMAR AND LAOS.

#### 1. The High Income Economies ex Brunei

Singapore and Malaysia have higher levels of financial system development, deeper capital markets and more regional bank expansion led by CIMB, DBS, Maybank, OCBC, RHB and UOB. Singapore provides the vibrant shipping port for trade and acts as a financial hub for wealth with strong presence from global investors across insurers, asset managers, private wealth and sovereign wealth funds. Malaysia provides a gateway to Islamic finance, a vibrant local currency capital market, and the corridor into ASEAN from the wealthy Middle East investment sector.

Singapore is consistently the most favoured RHQ location for MNCs, although Malaysia is keenly competing via the prominent InvestKL campaign. For banks operating in the region, Singapore's robust regulatory environment, deep talent pool and ASEAN connectivity, brands it as a typical first choice for Regional and Network banks. Singapore's prominence in ASEAN banking is best illustrated by the USD163m a month its banks direct from advanced economies to emerging Asian economies8. Naturally, Singapore's special intermediary role also makes it a highly competitive banking market, with high office rental costs and continuous technology and operational advancements required to stay ahead of the competition. Singaporean local banks have large deposit franchises which they can leverage when writing longer tenor assets, while foreign Regional and Network Banks typically accept shorter, low cost liabilities to match-fund a primarily trade-focused asset book.

For many MNCs while Singapore may be the RHQ, the scale of operations tends to be more weighted to the

Mid Manufacturing Competitors utilising Philippines as a services hub, Vietnam as a production base and/or Thailand as a logistics hub for regional production networks across the Mekong. In this example, Partnership Banks may be more inclined to opt for a strong Regional Bank out of Singapore or Malaysia that can standardise processes from the RHQ across multiple countries' operations at a service level more similar to that expected by MNCs in their home domicile.

#### 2. The Mid Manufacturing Competitors

With large support from state agencies, Thailand aspires to emulate Singapore as a trading hub, and is emerging as ASEAN's logistics centre for companies expanding into Vietnam, Cambodia, Myanmar and Laos. After the Asian Financial Crisis, BBL proved the only ASEAN-based bank to maintain its broad international reach and remains active in branches or subsidiaries across 9 of the 10 ASEAN countries. Beyond, BBL, the Thai banks are predominantly Network Banks weighted to Greater Mekong region coverage.

Indonesia and Philippines both represent a largely underbanked consumer base, with large growth potential. It is difficult for banks based in these high growth, high population, vast archipelagos to justify overseas expansion into lower growth Singapore, Malaysia and Thailand. This is especially true when the prudential regulators in the High Income Economies and Thailand require substantial upfront capital commitments that would encompass a sizable proportion of even the largest Indonesian and Philippine banks' capital bases.

Vietnam's indigenous banking sector remains highly crowded, solely domestically focused and dominated by the four largest state-owned banks. The local currency market is relatively shallow and hedging Vietnamese Dong exposures beyond a year is very difficult. Despite this, a large number of MNCs utilise the low wage base in Vietnam as a production hub, and onshore branches and subsidiaries have been prioritised by many commercially oriented foreign banks operating in ASEAN.

For Partnership Banks supporting clients into the Mid Manufacturing Competitor subregion, a nimble partner with local insights is important. Anecdotally foreign banks operating in the Mid Manufacturing Competitor subregion are more conservative relative to local banks due to perceived risk of banking licence loss or reputational damage. This can translate to more onerous or slower documentation requirements relative to local banks, particularly where Regional Banks utilise a standardised documentation and process framework. These frameworks are highly effective for a regional relationship with corporates because the same terms can apply across multiple jurisdictions, however they can also make these Regional Banks less nimble as they cater to the most conservative regulatory framework of countries covered. Where operations are in a single country only, a local partner or Network Bank may be more streamlined for the specific trade corridor, but there may be trade-offs. Multinational corporates may expect a consistent servicing level across geographies which is more easily achieved by a Network or Regional Bank. Network Banks may threaten the incumbent core banking relationship if they compete in the

Partnership Banks' own territory and can provide a strong end-to-end cross-border proposition.

#### 3. The Mekong Frontier

Meanwhile, across the Mekong Frontier, the banking sector and nascent capital markets still have far to come before bilateral, sustainable growth with stronger ASEAN banking neighbours can be considered. For these developing markets, bank priorities are less concerned with regional opportunity costs and understandably more geared to domestic development. This includes supporting domestic financial inclusion for the growing consumer base, funding the USD250bn<sup>9</sup> estimated credit gap for small and mediumsized enterprises (SMEs), and financing the requisite infrastructure developments for industry.

For MNCs expanding into this subregion, broader ASEAN connectivity and strong governance become the overriding drivers of bank decisions. For many expanding corporates, Regional Banks can give insights and comfort on their investments and corporate structure including credit, follow-on funding or exit strategies by connecting players across ASEAN. However, there are only a handful of Regional Banks, with branch or subsidiary operations across this entire subregion, which limits choices for Partnership Banks and Network Banks. With the Mekong Frontier representing the fastest growth opportunity in ASEAN, it seems highly likely that this banking space will expand with Thai banks likely leading the charge as they position for a land bridge with their significant trading partner, China.

<sup>8.</sup> BIS Quarterly Review (September, 2015). SGD204bn (USD163bn equivalent) is average monthly lend based on data from June 2012 to September 2014.

<sup>9. &</sup>quot;A New Regime of SME Finance in Emerging Asia: Empowering Growth-Oriented SMEs to Build Resilient National Economies" Shigehiro Shinozaki, Asian Development Bank (Dec-12)

## THREE LONG-TERM TRENDS STAND OUT AS ASEAN FINANCIAL INTEGRATION DEVELOPS

ANZ has identified three interesting trends emerging as ASEAN financial development accelerates. The first is the growing importance of the Mekong Frontier to MNCs, necessitating improvements in service levels as well as regional and global banking connectivity to the region. The second is the proliferation of intra-regional ASEAN bilateral treaties which give rise to indigenous Regional Banks with greater market access and foster harmonised national regulations among member countries. And the third is the emerging importance of increasing local currency cross-border flows and active de-dollarisation to mitigate against external shocks and reduce transaction costs for companies engaging in cross-border operations.

#### 1. Growing importance of the Mekong Frontier to MNCs

China still holds the mantle of the world's factory, however rising wages in the mainland are forcing many MNCs to consider the advantages of the Mekong Frontier's special zones, abundant resources, youthful population and inexpensive labour. The migration south of production platforms from the expensive and elderly production bases of North Asia, in conjunction with consumer growth in-country, will be strong drivers for the Mekong Frontier economies.

In fact, ANZ Research expect the Mekong Frontier economies of Vietnam, Cambodia, Laos and Myanmar to grow so rapidly that by 2025 their combined economies will be larger than that of Malaysia<sup>10</sup>.

The Mekong Frontier countries and Vietnam have until December 31, 2015 to meet the AEC's duty and tariff reductions which have already been met by the other 6 ASEAN nations. Representing the lowest cost wages in Asia, these countries have much to gain from the AEC and are increasingly prominent in the economic expansion plans of Asia's economic giants, Japan and China, via a 'Plus One' strategy.

However, there are also risks as ASEAN Free Trade Agreement terms entered into with Australia, China and India begin to apply. Cambodia already holds a significant trade imbalance with China and Vietnam has devalued the dong three times this year as it maintains its positioning as a light manufacturing competitor to China. AEC compliance, in particular to the ASEAN-China Free Trade Agreement, may be a challenging issue for the Mekong Frontier nations in the near term. While delays to AEC will be detrimental to domestic manufacturing capacity for the Mekong Frontier economies, the push into the sub-region from MNCs is already well underway.



#### MEKONG FRONTIER MOMENTUM

While many Regional and Network Banks have operations in Thailand and Vietnam, only a handful have local operations across all Mekong Frontier economies. Given the relatively small scale of Cambodia, Laos and Myanmar economies relative to their ASEAN neighbours, what is the payoff for end-to-end trade service delivery in the sub-region?

RMB trade capabilities are in growing demand as Chinese manufacturers improve their margins, in a growing wage environment, by outsourcing lower value manufacturing to the cheaper labour markets of the Mekong Frontier. Meanwhile Japan's 'Thailand Plus One' business model incentivises companies, including Japan's lucrative auto

MNCs then transfer the labour-intensive parts of their production processes to special economic zones in Cambodia, Laos and Myanmar near the Thai border.

The dispersion of Asia's production across China, the Mid Manufacturing Competitors and the Mekong Frontier creates complexities for MNC CEOs as they consider how to rebalance their regional operations. With every Samsung, Piaggio and Toyota investing in low-cost Mekong Frontier supply chains, there comes an inevitable flood of questions regarding supplier risk, inventory/partnership/distributor risk, foreign exchange and interest rate risk. Partnership Banks from OECD countries that support corporate trade to the region therefore rely on

the enhanced service levels, only available from local bank

Thailand Plus One was a key driver for ANZ's decision to invest in a full banking licence in Thailand. Approximately 20% of export settlements from Thailand within ASEAN are carried out in Thai Baht and the importance of this currency to the Mekong Frontier's infrastructure development and financing was emphatically demonstrated with the Government of Laos' Thai Baht denominated bond program It is widely expected that Myanmar, Cambodia and Vietnam will also follow suit, with Thailand emerging as the ASEAN home base for Mekong Frontier economies and their 'land bridge' position into key trading partner, China.



10. ASEAN – The Next Horizon, ANZ Research In Depth Series (April, 2015). 11. ASEAN Rriefing (ASEAN's 2015 AEC Compliance Deadline – What It Actually Means' (May 2015).

# WHILE A COMMON CURRENCY IS SHARED BY SINGAPORE AND BRUNEI, ASEAN HAS EMPHATICALLY RULED OUT A SINGLE CURRENCY FOR MEMBER COUNTRIES GIVEN THE VASTLY DIFFERENT LEVELS OF INCOME ACROSS MEMBER COUNTRIES.

### 2. The proliferation of intra-ASEAN bilateral treaties under ABIF

With banks comprising the largest component of ASEAN's financial sector, the ABIF could be the game changer. To summarise, under the ABIF, member countries sign reciprocal bilateral deals for their banks to operate in a partner country on the same terms as domestic banks. Banks which are proposed by their country's central bank for a regional presence will be termed, "Qualified ASEAN Banks" (QABs). Figure 7 provides a high level overview of the proposed timeline for ASEAN banking integration.

Prima facie, the ABIF provides ASEAN domiciled Regional Banks, these QABs, with more access and operational flexibility than Regional or Network Banks from outside the bloc. However, this favoured status may reduce the desirability of collaboration with local Partnership Banks in ASEAN due to a perceived threat in home markets. This threat will be largely contingent on the terms of the bilateral treaty which may limit QAB penetration in certain protected domestic market segments.

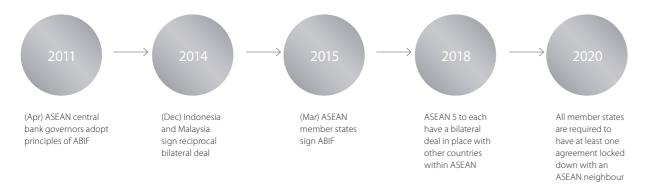
Foreign Regional Banks and Network Banks with significant invested capital in presence countries will be eyeballing

the minimum regulatory requirements agreed in the reciprocal arrangements for QABs. Indonesian banks have very publicly noted that entry imposts for relatively low growth countries, Singapore and Malaysia, prohibitively dilute returns as compared to business-as-usual profitability in the Indonesian market which QABs from Singapore and Malaysia can enter at a fraction of the capital cost. Singapore, for example, is an international financial centre with high minimum paid-up capital requirements on Basel III rules implemented more stringently than Basel Committee of Banking supervision minimums. On the other hand, half of the ASEAN bloc have yet to even consult on Basel III and international financial reporting and governance standards. Figure 8 shows the vast differences in minimum capital entry requirements for domestic banking operations in Singapore and Indonesia.

#### 3. De-dollarisation: will a long term trend emerge?

Financial services liberalisation is the key feature of the ABIF, however the other important element to broader ASEAN Financial Integration is capital account liberalisation. While ASEAN has emerged as a highly open trading region,

FIGURE 7: ASEAN Banking Integration Timeline



cross-border lending, borrowing and hedging is still highly controlled and almost all member states place restrictions on the offshore use of their currencies. As such, there is very little depth in many intra-ASEAN currency pairs and the vast majority of current trade, foreign direct investment and portfolio flows, even intra-regional are denominated in US dollars (USD).

While a common currency is shared by Singapore and Brunei, ASEAN has emphatically ruled out a single currency for member countries given the vastly different levels of income across member countries. However, there have been a number of calls from central banks and supranationals for emerging Asian economies to actively engage in de-dollarisation<sup>12</sup> "to mitigate against external shocks and constraining the central bank's ability as lender of last resort" (IMF). These calls go right to the heart of the ASEAN Central Banks' Working Committee on Payment and Settlement Systems' (WC-PSS) work on increasing the efficiency of cross-border trade settlement in ASEAN by reducing foreign exchange spread and bank charges.

FIGURE 8:
Entry Requirements – Singapore, Indonesia



Source: Bank Indonesia citing ABIF taskforce, 2012

12. Including from Naoyuki Shinohara, IMF, as well as the Bank Negara Malaysia

### IS ABIF EVENING UP THE PLAYING FIELD?

With no ASEAN central bank, all agreements operate on a policy of consensus. This means that bilateral deals under the ABIF could end up highly customised with each bilateral partner as the AEC takes the time to work through moving parts. It may be that specific segments within a country's banking sector are liberalised based on a QAB's commercial interests and each country's strategic imperatives. It seems probable that QABs bring their capital, governance and liquidity standards up to the minimum requirements of the country with lower risk tolerance. This may give incumbent Regional and Network Banks, both indigenous ASEAN and outsiders, a big leg up because home-host regulations have already been met. There is also scope for future bank access negotiations as outsider countries initiate bilateral agreements and broader regional free trade agreements with ASEAN member countries. Some of the key free trade agreements with ASEAN countries are pictured in Figure 9.

GURE 9:



Regional Comprehensive Economic Partnership

Trans-Pacific Partnership

#### **TRENDS**

### Intra-ASEAN forex pairs: Could this be the first ASEAN bilateral currency exchange pact?

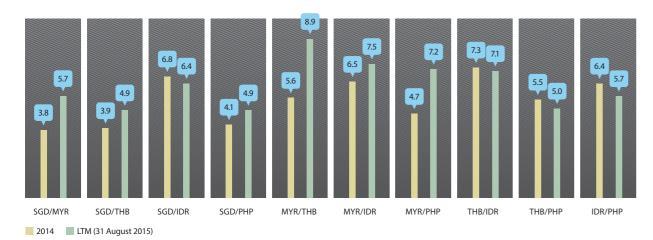
Recent swings in global currencies have brought exchange-rate risk back to the attention of ASEAN central banks. In August 2015, the Bank Negara Malaysia and Bank of Thailand signed a Memorandum of Understanding on the establishment of a framework for co-operation to promote the settlement of bilateral trade and direct investment in their local currencies. This is the first ASEAN bilateral currency exchange pact and could be the start of direct intra-regional foreign exchange crosses, bypassing the USD as a trade conduit.

Subject to market depth and liquidity, as measured by bid-ask spreads and volatility, direct currency crosses can substantially reduce costs for participants by taking the USD leg out of the transaction. It removes the settlement risk and time lag with the USD correspondent bank, as well as the capital for the additional bank exposure. Additionally, many of the compliance burdens associated with US reporting regulations may be reduced.

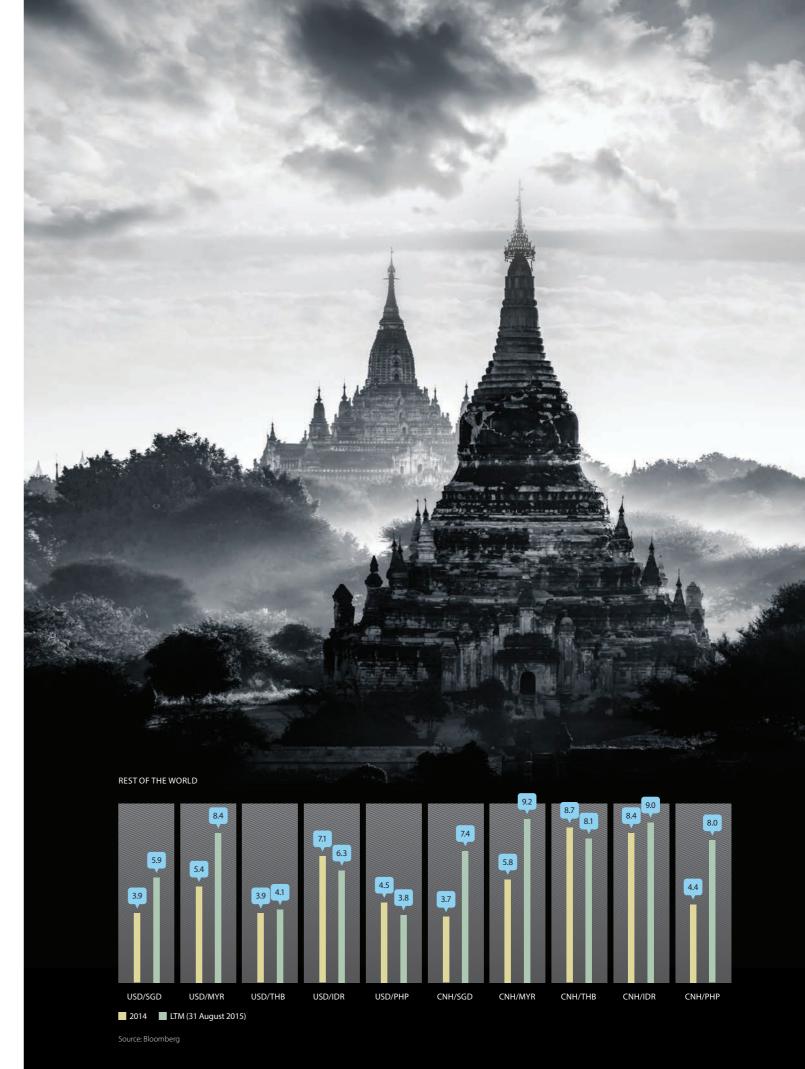
However, capital account liberalisation is a requisite if the use of ASEAN currencies for intra-regional trade is to take-off. This will not be at an even pace across the three sub-regions. Opening capital flows too fast in developing ASEAN markets would bring financial instability, while going too slow prevents the efficiency and cost improvements of direct ASEAN currency foreign exchange in intra-regional trade settlement. This would run counter to the goals of the WC-PSS.

ANZ analysis of currency pair data over the last three years supports the idea of bypassing the USD for some of the more liquid direct ASEAN foreign exchange pairs. Indeed relative to USD crosses, volatility between ASEAN currencies has proved low and stable, particularly for Malaysian Ringgit (MYR), Singapore Dollar (SGD) and Thai Baht (THB). Figure 10 shows annualised currency volatility over 2014 and the last 12 months to 31 August 2015. Despite all the market turmoil in 2015, the SGD/MYR cross rates had annualised volatility of 5.7% compared with USD/MYR of 8.4% and USD/SGD of 5.9%. Figures for calendar year 2014 show even lower levels of volatility for the SGD/MYR crosses. The lower volatility of such a pairing could also support a reduced market risk capital assignment for those transactions relative to a USD cross and significantly reduce capital imposts and resultant transactional charges for cross-border trade settlement.

FIGURE 10: **FX volatility 2014-15** INTRA-ASEAN



Source: Bloomberg



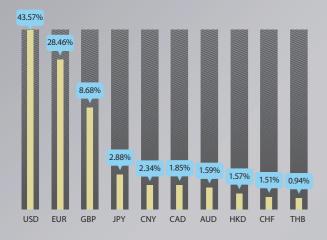
#### IS IT ALL HYPE?

De-dollarisation has implications for all banks, with foreign exchange revenues often a strong driver for targeting cross-border business. Often Regional and Network Banks overlook local currency trades in favour of a larger, aggregate USD balance sheet scaled from several countries' operations. Local banks with strong local currency liquidity are at a comparative advantage, however this is dependent on capabilities beyond spot as the foreign exchange needs of ASEAN companies and investors becomes more complex. limited, however Partnership Banks may need to re-evaluate capabilities of their ASEAN bank partners as demand rises longer term.

Much of the recent discussion on de-dollarisation has centred on China's growing importance as a trading partner to ASEAN and the replacement of USD by Chinese Renmimbi (RMB) for trade settlement. In reality, ANZ finds that once arbitrage and reinvoicing out of centres like Hong Kong are excluded, the underlying 'true RMB trade' volumes

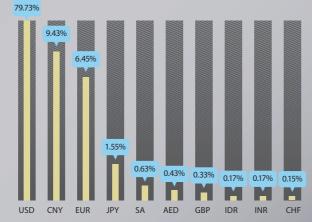
remain low. Global payments and trade volumes data from SWIFT Watch, shown in Figures 11 and 12, highlight that increased adoption of trading partner currencies still has a long run to catch USD denominated trade. However, like many of the Regional Banks, ANZ considers the China-ASEAN trade corridor central to its ASEAN banking operations and remains at the forefront of RMB developments as Chinese capital account liberalisation continues. Increasing RMB denominated trade is expected as a long term trend and Smaller local currency hedging capabilities are currently quite ANZ is keeping an open mind to long-term de-dollarisation of payments and trade flows from other major extra-ASEAN contributors including Europe and Japan.

FIGURE 11: Customer Initiated and Institutional Payments. Inbound + Outbound traffic. Based on Value (Jul-15) Percentage (%)



Source: SWIFT Watch

FIGURE 12: Letters of Credit and Collections. Inbound + Outbound traffic. Based on Value (Jan-15)



Source: SWIFT Watch

#### BY THE END OF THE DECADE, ASEAN IS FORECAST TO EMERGE AS THE FIFTH LARGEST ECONOMY IN THE WORLD WITH A COMBINED NOMINAL GDP OF USD4.5TRN.

This growth, combined with the promise of financial integration and internationalisation of the ASEAN region presents a compelling long term opportunity for many companies. For banks, ASEAN coverage is now an imperative to support customers into ASEAN's golden period.

To satisfy MNC's increasing needs in the ASEAN region, ANZ has identified three approaches taken by banks: Regional Banking, Network Banking and Partnership Banking. Winners in ASEAN banking will have a clear vision of which approaches best leverages their competitive strengths onshore in ASEAN or extends their capabilities, insights and reach via collaboration.

Importantly, winners will be those that can strike the right balance between local insights and regional synergies. No one bank can claim full coverage across ASEAN's 10 member countries, so selecting the 'right' partner for strategic collaboration will be a key to success for all banks. For ANZ, complementary geographic presence, local credibility and a disciplined execution to strategy are key differentiators. In this regard, ANZ enjoys long standing relationships with many banks across the world and has a proven track record partnering with and meeting the unique and differing needs of our customers.



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