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Oliver Wyman

WORLD ECONOMIC FORUM

Navigating Global Financial System Fragmentation

INSIGHT REPORT
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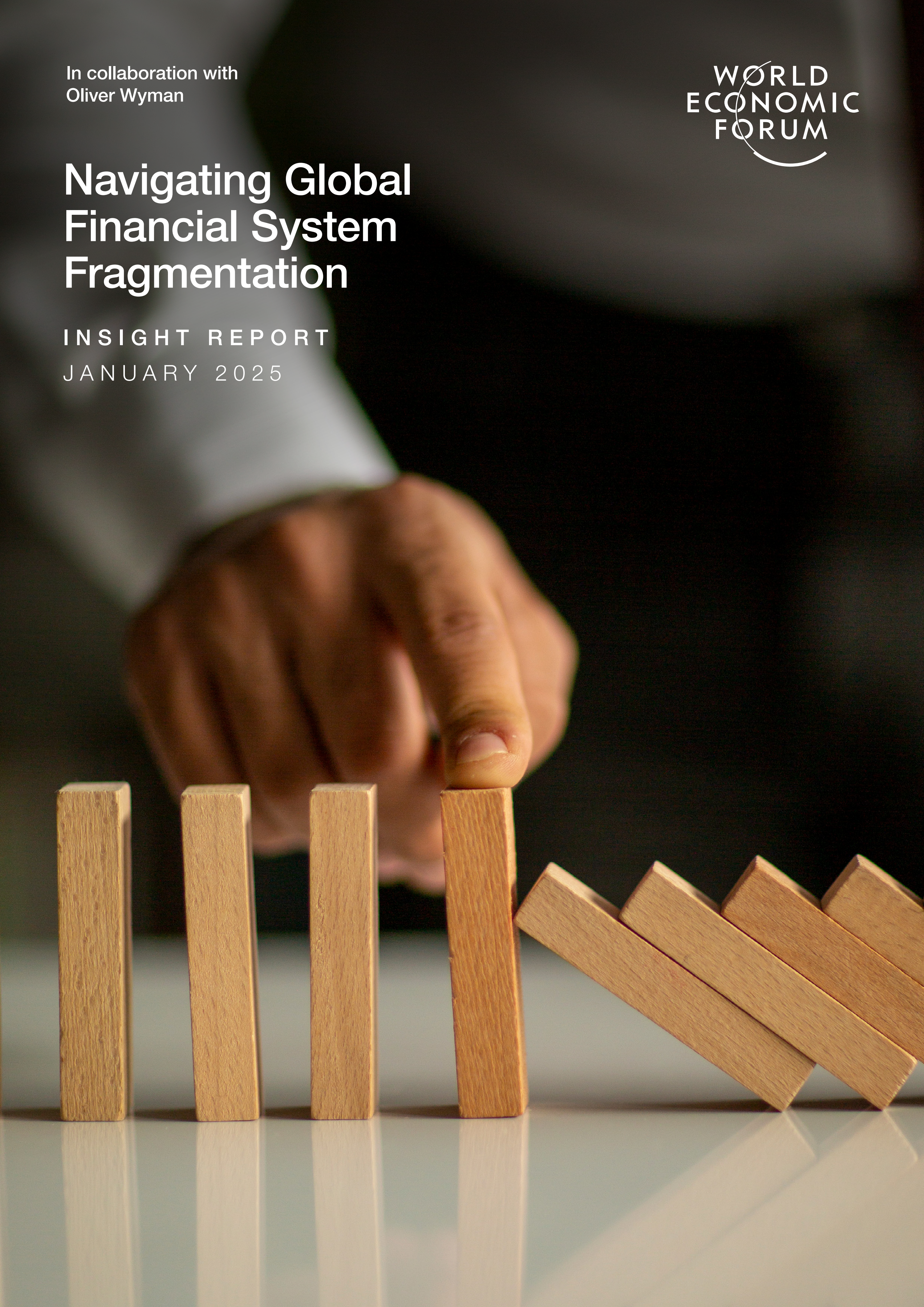

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Foreword

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The global financial system is among the most interconnected and interdependent ecosystems in the world. Global cross-border bank credit stands at nearly $40 trillion, roughly the size of the GDP of the United States, Germany, Japan and India combined. Bond issuances by governments and corporates totalled $9 trillion in 2024, with investors allocating an additional $600 billion to global bond funds. The total value of cross-border payments in 2023 was estimated at more than $190 trillion.

For decades, this system has served as the engine for global economic growth through its financing of the real economy. It is composed of an interconnected network of actors, both domestic and international, including central and commercial banks, investment firms and insurers, and regulators, all of which work together to allocate resources, manage risks and provide necessary liquidity. Its functioning promotes growth, stability and integration by moving the funds required for development and commerce, supporting individuals, corporates and governments.

Like any social system, it has developed around a common set of rules, principles and norms, both explicit and implicit, that functionally underpin the system's architecture and establish trust between its actors, allowing firms to conduct business across borders. These elements include respect for property ownership rights, the fundamental rule of law and the independence of fiscal and monetary policy. They have allowed the system to contend with disruptions, both chronic concerns and shocks, the most famous being the global financial crisis. Financial institutions acted together to save the system – such as when the US Federal Reserve used swap lines to provide emergency dollar liquidity to 14 central banks – both out of societal obligation and self-preservation.

This understanding, however, is increasingly at risk in a complex geopolitical environment defined by excessive fragmentation, multipolarity and the growing use of geoeconomic statecraft. More and more, states seek to use the global financial system to advance geopolitical objectives. This poses a threat to the very integrity of the system and will have costs at a macroeconomic level as well as for financial institutions, ranging from asset stranding and valuation volatility to reduced liquidity and credit-rating risks.

The Navigating Global Financial System Fragmentation initiative convenes more than 25 chief executives, chairpersons and other global finance leaders to reinforce the integrity of the financial system at this moment of rising geopolitical complexity. This report aims to clearly articulate and codify those core rules, principles and norms that can preserve the system while also making the case for the immense opportunity provided by enhanced coordination and integration.

The report represents a call to action from the private sector to protect the global financial system's most essential elements, without undermining national security or sovereignty. By considering these frameworks, policy-makers can establish the necessary conditions for efficient capital markets and enable continued economic growth for decades to come.

Executive summary

An integrated global financial system supports livelihoods and underpins economic growth. This report proposes eight principles to protect the system's integrity and rules of engagement to put them into practice.

Financial integration powers economic growth and makes capital available to entrepreneurs, corporations, governments and citizens. The global financial system connects institutions, regulators and technologies to facilitate capital exchange across borders. Its interconnections have supported recent decades of economic growth and human development. In the quarter-century between 1990 and 2015, more than 1 billion people worldwide were lifted out of poverty.[1] To continue this growth path, a well-functioning and integrated financial system that mutually benefits all countries is necessary.

The current trajectory of the global financial system, however, suggests that the 21st century may see a more fragmented financial architecture. Russia's 2022 invasion of Ukraine, and the corresponding responses from Western governments to restrict Russia's access to the global financial system, represented an inflection point that accelerated fragmentation. Market participants are increasingly basing decisions not just on return-maximization but also on geoeconomic considerations, triggering a shift away from the previous globalized model.

To advance domestic economic priorities and national security imperatives, policy-makers must often accept trade-offs that cause fragmentation and might, for instance, reduce the efficiency of international finance – a certain degree of fragmentation is likely necessary to achieve desired policy outcomes. At the same time, financial regulators recognize the benefits of financial integration and minimizing the burdens placed on legitimate economic activity. For several decades, improvements in technology, innovation and governance have made it possible to increase efficiency while reducing regulatory friction. In recent years, however, regulatory friction has increased in tandem with growing geopolitical tensions, leading to what many observers describe as excessive fragmentation.

Fault lines are emerging within the global financial system, with cracks beginning to show across both regions and levels of economic development. Despite the international order and financial system becoming more multipolar, analysis suggests that a globalized system is likely to persist in the near term. As more governments prioritize the use of economic statecraft (i.e. the economic tools and policies a state uses to achieve foreign policy and domestic objectives), however, there is a risk of further financial system fragmentation.

The potential risks of financial fragmentation make a strong case for policy-makers and financial actors to choose a different path – of reinforcing the global financial system by enhancing regulatory cooperation and further standardizing frameworks for financial transactions. By integrating emerging technologies such as blockchain and artificial intelligence (AI), countries may help improve transparency and efficiency in cross-border payments. Multistakeholder cooperation can strengthen financial governance and help mitigate systemic risks, ensuring that financial markets operate fairly and effectively. This approach promotes stability and resilience in the global economy, promoting trust among stakeholders.

The costs of financial system fragmentation

As nations have increasingly sought to protect their financial systems from external threats, new challenges have arisen, prompting regulatory and institutional shifts designed to enhance resilience, support domestic industry and insulate supply chains from external shocks. For example, following the COVID-19 pandemic, many nations invested in "friend-shoring" to reorient supply chains in ways that afforded them greater protection over critical infrastructure.

Such regulatory and institutional efforts can insulate certain sectors but also increase the complexity of the corresponding financial infrastructure and uncertainty for investors, thereby reducing liquidity, which can cause numerous unintended consequences and knock-on effects. This report represents a concerted effort among global financial actors to assess these impacts, mitigate the negative consequences of fragmentation and propose foundational principles that can strengthen the financial system even amid geopolitical reconfigurations.

$5.7 trillion

Potential lost GDP as a result of fragmentation.

Financial system fragmentation can have a negative impact by decreasing global economic output and increasing inflation. This report presents new analysis indicating that one-year economic output losses from fragmentation could range from $0.6 trillion to $5.7 trillion, or about 5% of current global gross domestic product (GDP) and twice the output losses caused by the COVID-19 pandemic, depending on the degree of fragmentation. Similarly, inflation rises steadily in most countries as fragmentation increases, which is likely to necessitate higher interest rates and have an impact on borrowing costs for individuals, businesses and governments.

Another consideration is that fragmentation's negative effects will not be distributed equally around the world. Instead, countries or regions that lack sufficiently deep or integrated capital markets will be affected more significantly. According to the report's analysis, emerging markets and developing economies (EMDEs), not including China or Russia, could see GDP losses of nearly 11%. These changes may force smaller EMDEs to seek alternative sources of funding outside the traditional international system, further exacerbating fragmentation. This fragmented environment could complicate sovereign debt-relief efforts and erase previous progress in this area as creditors pursue separate bilateral negotiations with debtors.

Geopolitics also affects private-sector decision-making by increasing policy uncertainty and making long-term strategic planning more challenging. Research suggests that businesses could see impacts on corporate credit, as rating agencies re-evaluate debt profiles across various jurisdictions and blocs. Other impacts include limited market access, as economic sanctions and other measures prohibit investors and companies from entering certain markets. Finally, asset valuations could be impacted, as weakened investor appetite limits deal opportunities, reduces liquidity and contributes to asset-stranding – all of which increase valuation volatility.

Alternatively, private sector-led collaboration could offset geopolitical friction and financial fragmentation by linking actors across rival blocs. Financial intermediation tends to occur despite geopolitical tensions or even wars. As such, it offers a powerful tool for bringing actors together to address shared challenges, such as the energy and digital transitions, ageing populations and infrastructure investment, all of which require collective action.

The guardrails outlined in this report are designed to protect the ability of the financial sector to fulfil its fundamental role of intermediating global savings and channelling them to promote investment and economic growth, regardless of the geopolitical backdrop.

Guardrails to protect the integrity of the global financial system

In a recent speech, International Monetary Fund First Deputy Managing Director, Gita Gopinath, called on countries to "build resilience", but warned that "in the absence of sufficient guardrails, we could end up with severe fragmentation of the global economy and consequently lower productivity and income levels for everyone".[2]

This report proposes specific guidelines to protect the system's integrity at a moment of increasing geopolitical complexity.[3] The use of the term "guardrail" does not suggest limits on national sovereignty. Instead, this report's guidelines, informed and articulated by private-sector leaders from across global financial services, provide a framework to guide future economic statecraft in ways that safeguard the global financial system and facilitate ongoing integration, even in the face of geopolitical tensions.

The Principles to Safeguard the Global Financial System from Fragmentation listed in Figure 1 assert the basic conditions that enable financial-services actors to conduct business across jurisdictions and whose protection preserves the integrity of the global financial system.

FIGURE 1 **Principles to Safeguard the Global Financial System from Fragmentation**

Principle 1

Clearly define and uphold the rule of law to ensure impartial enforcement and predictability across the financial system

Principle 2

Respect financial and physical property ownership rights to maintain trust and encourage investment, thereby fostering financial stability

Principle 3

Avoid unilaterally expropriating sovereign assets even during times of heightened tensions or conflict

Principle 4

Safeguard independence and bolster the capabilities of international institutions, such as standard-setting bodies, to preserve their role in global financial governance

Principle 5

Regulate and manage critical financial market infrastructures, but avoid politicizing or severing the underlying financial rails, given that these systems are essential for maintaining the integrity, functionality and efficiency of the financial system

Principle 6

Ensure parallel financial market infrastructures are interoperable to facilitate optimal transactions and market efficiency

Principle 7

Structure domestic and multilateral policies and financial regulations to support financial stability and ensure cross-border flows of capital, data, goods, people and ideas

Principle 8

Shield the independence of fiscal and monetary policy to promote financial stability, reduce the risk of competitive interference and increase opportunities for transparent decision-making

Source: World Economic Forum and Oliver Wyman

The Rules of Engagement for Responsible Economic Statecraft proposed in Figure 2 operationalize these principles. They outline how policy-makers can deploy economic statecraft to protect national security and sovereignty without reducing global prosperity.

FIGURE 2 **Rules of Engagement for Responsible Economic Statecraft**

Rule 1

Design and implement targeted and well-aligned statecraft measures to minimize the risk of unintended consequences and reduce the private sector's administrative burden (e.g. carry out cost–benefit analyses, provide clear implementation guidance, and assess and reinforce existing regimes)

Rule 2

Establish public–private consultation mechanisms to promote transparency in decision-making regarding the impact of economic statecraft measures on the financial system

Rule 3

Protect populations, sectors, industries and supply chains for humanitarian purposes through exemptions and carve-outs to avoid collateral damage and ensure their continued access to the global financial system

Rule 4

Prioritize the use of economic inducements, including trade agreements compliant with international law, and other financial instruments that foster mutual gain and cooperation over those designed to cause economic pain

Rule 5

Collaborate on areas of geoeconomic consensus, including combatting financial crime, terrorist financing and the energy transition, recognizing the need for collective action to address these global financial challenges

Rule 6

Promote global financial stability through heightened coordination among major financial powers via transparent data sharing and inclusive decision-making to minimize negative spillovers and prevent system fragmentation

Rule 7

Reform the global financial system to reflect 21st-century geopolitical and macroeconomic dynamics and provide greater benefits to EMDEs, promoting inclusive economic growth and stability

Rule 8

Protect the ability of firms to engage with actors across the geopolitical spectrum by structuring statecraft measures, standards and regulations on a multilateral basis, whenever possible

Source: World Economic Forum and Oliver Wyman

Policy recommendations to establish guardrails

By strengthening and reforming the system, policy-makers can ensure its integrity and guarantee that all actors, including EMDEs, have the ability to conduct business across jurisdictions. As global population and economic dynamics shift, global governance systems must adapt to ensure the financial system delivers maximum benefits.

This report offers a pragmatic approach to translate the proposed frameworks into action that supports economic growth. Core policy recommendations include: anchoring guardrails through voluntary norms, which build on those outlined in this report; developing mutual recognition frameworks and interoperability between regulatory regimes; and countering fragmentation with new or strengthened patterns of economic cooperation and policy coordination.

Introduction

Global finance leaders are working together to establish norms and principles that safeguard the financial system in the face of geopolitical fragmentation.

Recent political developments, combined with demographic shifts and changing economic trends, have reconfigured the landscape for global finance. Geopolitical fragmentation represents one of the most pressing issues affecting financial services on a global scale.[4]

As a result, today's financial actors face numerous challenges. In March 2024, the World Economic Forum's Centre for Financial and Monetary Systems and Oliver Wyman launched the Navigating Global Financial System Fragmentation initiative, which brings together more than 25 chief executive officers, chairpersons and other global finance leaders to understand the new landscape and define a common set of norms, rules and principles to safeguard the global financial system during a period of rising geopolitical complexity.

This report proposes frameworks to protect the financial system, outlines the quantitative and qualitative costs of fragmentation and provides policy-makers with guidance and tools to activate these frameworks that protect global prosperity.

1

Past, present and future of the global financial system

Historical developments since the 1970s have reinforced a unified global financial system with the US dollar at its centre, but current trends point towards a more multipolar and fragmented future.

For the past half-century, the global financial system has continuously evolved in its role as the world economy's major artery. Finance has driven global growth by increasing cross-border capital flows, enabling a more harmonized international regulatory environment and supporting rapid technological progress that improves the efficiency and reach of financial markets.

Despite these gains, rising geopolitical tensions have changed the landscape in which today's financial system operates, and these conditions necessitate a re-evaluation of the key pillars supporting the current system. Understanding the foundation of today's system can help inform decision-making to safeguard it for the future.

FIGURE 3 | **Timeline of key events in the global financial system's evolution**

1970s

Foundation of the modern global financial system

1971: US President Nixon ends Bretton Woods system, delinking US dollar from gold standard
1973: First oil crisis creates global economic turbulence
1974: Establishment of petrodollar system between the United States and Saudi Arabia
1979: Second oil crisis reinforces dollar's dominance
Late 1970s: Key institutional changes at US Federal Reserve begin long-term disinflation trend

1980s

Global deregulation and integration

1980s: Major financial deregulation and innovation period begins
- Easing of foreign exchange controls
- Expansion of derivatives markets
- EMDEs shift to export-led growth strategies

1990s

Financial globalization and new technologies

Early 1990s: Broader adoption of real-time gross settlement systems transforms transaction capabilities
1991: Soviet Union's collapse accelerates financial globalization
1995: World Trade Organization (WTO) establishment creates new framework for trade/financial integration
Late 1990s:
- Rise of electronic trading platforms and internet-based finance
- Multiple regional financial crises prompt regulatory reforms

1999: EU introduces euro as an accounting currency, used by 11 member states

2000s

Continued integration and crisis

2001: Two pivotal events:
- China joins WTO, boosting global growth
- 9/11 attacks lead United States to use financial system as counterterrorism tool

2008: Global financial crisis halts rapid financial sector expansion
2009: G20 emerges as key coordinator of regulatory response
- Creation of Financial Stability Board
- Development of Basel III framework

2010s –2020s

Fragmentation pressures

Early 2010s: Rise of fintech and cryptocurrency alternatives
2013: China announces Belt and Road Initiative
2013: Federal Reserve surprises markets by announcing the tapering of asset purchases
2014: US and EU impose sanctions against Russia after Crimea annexation
2016: Brexit vote signals anti-globalization sentiment
2018: US–China trade war begins
2020: COVID-19 prompts supply-chain restructuring
2022: Russia's invasion of Ukraine reveals global fault lines
- US and EU freeze $282 billion in Russian central bank assets
- EU regulations mandate SWIFT to disconnect seven Russian banks

Source: World Economic Forum and Oliver Wyman

1.1 The US dollar's centrality

The US dollar's emergence as the foundation of the global financial system stemmed from deliberate policy choices and the unique economic position of the United States in the post-Second World War era through the Bretton Woods system. This international order pegged major international currencies to the US dollar, which itself was pegged to gold, in order to ensure exchange rate and monetary stability, prevent competitive devaluations and promote economic growth through trade. The modern financial system has evolved since the end of the Bretton Woods system in ways that have affirmed the US

> The strength of the US economy, the absence of viable alternative currencies and the emergence of the 'petrodollar' system led to the US dollar maintaining its core role in the emerging financial order.

dollar's centrality.[5] When US President Richard Nixon suspended the gold convertibility of the US dollar in 1971, some contemporaries viewed the move as a signal of the dollar's weakness. However, a series of historical forces and events converged to increase the dollar's centrality in subsequent years. The underlying strength of the US economy, the absence of viable alternative currencies and the emergence of the "petrodollar" system resulted in the US dollar maintaining its core role in the emerging financial order. A linchpin of the system involved a US arrangement with Saudi Arabia in the 1970s to ensure that the global oil trade would be conducted in dollars, which created a perpetual source of dollar demand.[6]

The US dollar became increasingly central to the development of the global financial system in subsequent years, due to structural and institutional factors. Deep and liquid US financial markets, combined with relatively predictable monetary policy, strong legal frameworks and political as well as institutional stability maintained the currency's appeal for international transactions and reserves. Moreover, the US dollar's entrenched role in global trade and commodity pricing and its widespread use in international contracts created powerful network effects that resist change.

1.2 Integration of a global system

The 1980s and 1990s saw the formation of a truly integrated global financial system through three parallel developments. First, financial deregulation and innovation created interconnected global capital markets. The easing of foreign exchange controls and expansion of derivatives markets enabled unprecedented capital mobility.[7] For instance, the estimated outstanding stock of international bonds increased from $260 billion to $1.4 trillion between 1982 and 1990.[8] This deregulation coincided with many emerging markets (EMs) shifting from import-substitution strategies to export-led growth, further integrating global finance and trade.[9]

Technology played a crucial role in enabling this integration. The introduction of real-time gross settlement (RTGS) systems dramatically reduced settlement risk and contributed to more efficient cross-border transactions. Electronic trading platforms and the internet transformed financial markets, enabling faster trading (for example, the US stock market moved from a T+5 to a T+3 settlement cycle in 1995), better price discovery and improved access to information.[10] These technological advances significantly reduced the costs of international financial transactions and simultaneously increased their speed and reliability.

International arrangements further solidified the institutional framework for global integration. The establishment of the World Trade Organization (WTO) in 1995 created a more unified global trading system that encouraged financial integration. Most of Europe's largest economies further integrated their markets by adopting the euro as their common accounting currency in 1999. China's 2001 WTO accession marked another crucial milestone, integrating the world's then-most populous nation into global markets.[11] The 2007 US housing downturn, which triggered the global financial crisis, revealed the risks of integration but ultimately led to stronger international regulatory coordination through new institutions such as the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision (BCBS).

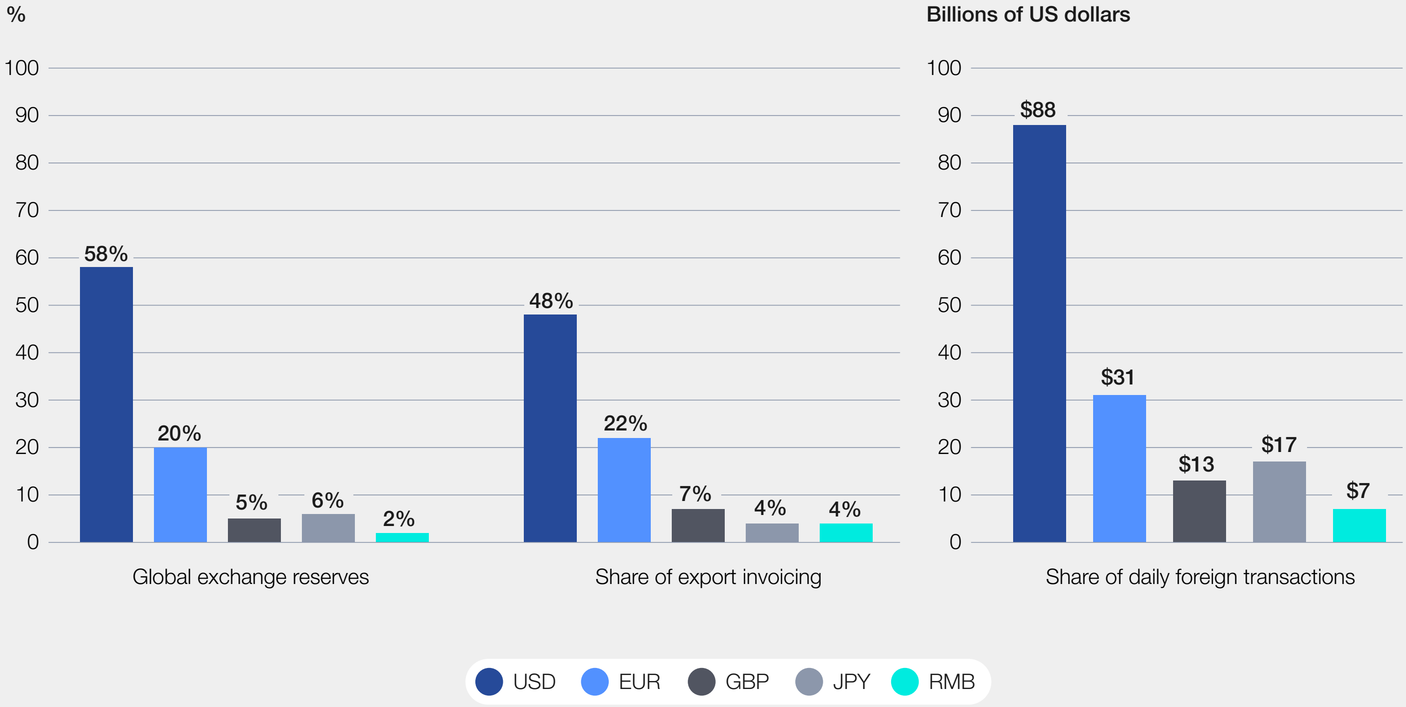
Cumulatively, these trends converged to create dramatic increases in foreign direct investment, which grew from 0.5% of global GDP in 1970 to a high watermark of 5.3% of global GDP in 2007, just prior to the 2008 crisis.[12]

BOX 1 The historic role of the US dollar

The Bretton Woods system established the US dollar as the global reserve currency. Growing fragmentation of the global financial system is partly fuelled by countries and companies seeking to mitigate the perceived risks associated with US dollar dependence such as changes in US monetary policy affecting global liquidity and other financial conditions.

Nevertheless, the US dollar is likely to maintain its dominance for the foreseeable future, given strong US fundamentals, a lack of credible alternatives and its powerful and entrenched network effects. The euro faces limitations due to the Eurozone's economic and political fragmentation, while the renminbi is constrained by its controlled capital account and lack of full convertibility. Other currencies suffer from insufficient scale and liquidity. Central banks prefer holding dollar reserves due to the currency's stability and liquidity, and, accordingly, the dollar maintains a dominant share of global foreign exchange reserves. Global trust in the US economic and financial systems and confidence in the US government's ability to meet its financial obligations collectively make the scenario of continued dollar dominance the most likely outcome.

FIGURE 4 | **Share of global exchange reserves, global export invoicing and foreign transaction by currency**



Note: To calculate share of export invoicing, project team used the Bloomberg Intelligence FX Strategy Dashboard and Global SWIFT data as a proxy using inbound and outbound traffic processed via SWIFT. To calculate share of foreign transactions, project team used the turnover of OTC foreign exchange instruments by currency, "net-net" basis, 2022 daily averages in billions of USD.

Source: Share of global foreign exchange reserves: IMF's Currency Composition of Official Foreign Exchange Reserves Q2 2024. Share of export invoicing: Bloomberg Intelligence FX Strategy Dashboard. Share of foreign transactions: BIS Triennial Survey, Data Portal. Oliver Wyman analysis

While the US dollar will likely continue to play a significant role as a reserve and funding currency, it is becoming less dominant as a medium of exchange for financing goods and services trade. Amid a trend towards greater trade regionalization, the renminbi and euro are expected to become more important within Asian and European trade.[13] Data from October 2024 shows that the renminbi is the second largest global currency in the trade finance market, with a share of 5.8%, just ahead of the euro but behind the US dollar, which has a share of around 83%.[14] Digital currencies, including wholesale central bank digital currencies (CBDCs), could provide alternative cross-border payment rails, creating a more diverse global financial landscape.

Moreover, rising debt levels in the United States raise questions about debt sustainability, while growing domestic political polarization could undermine the independence of US institutions. Over time, these developments could reduce confidence in the dollar and lead to a more multipolar currency system.

1.3 Use of the financial system for economic statecraft

Economic statecraft broadly refers to the use of economic tools and policies by a state to achieve its foreign-policy and domestic objectives.

Even as financial integration continued to deepen in the 2000s, challenges to the system began to emerge. A crucial turning point came after the terrorist attacks on 11 September 2001, which shifted some governments' view of the financial system not just as economic infrastructure, but as a powerful tool of economic statecraft.

Economic statecraft broadly refers to the use of economic tools and policies by a state to achieve its foreign-policy and domestic objectives. Such measures can include punitive steps such as sanctions, designed to pressure norms-violating countries and to protect the issuing government's interests, as well as inducements, such as trade agreements aimed at improving relationships and fostering cooperation.

TABLE 1 | **Economic statecraft – a deep dive**

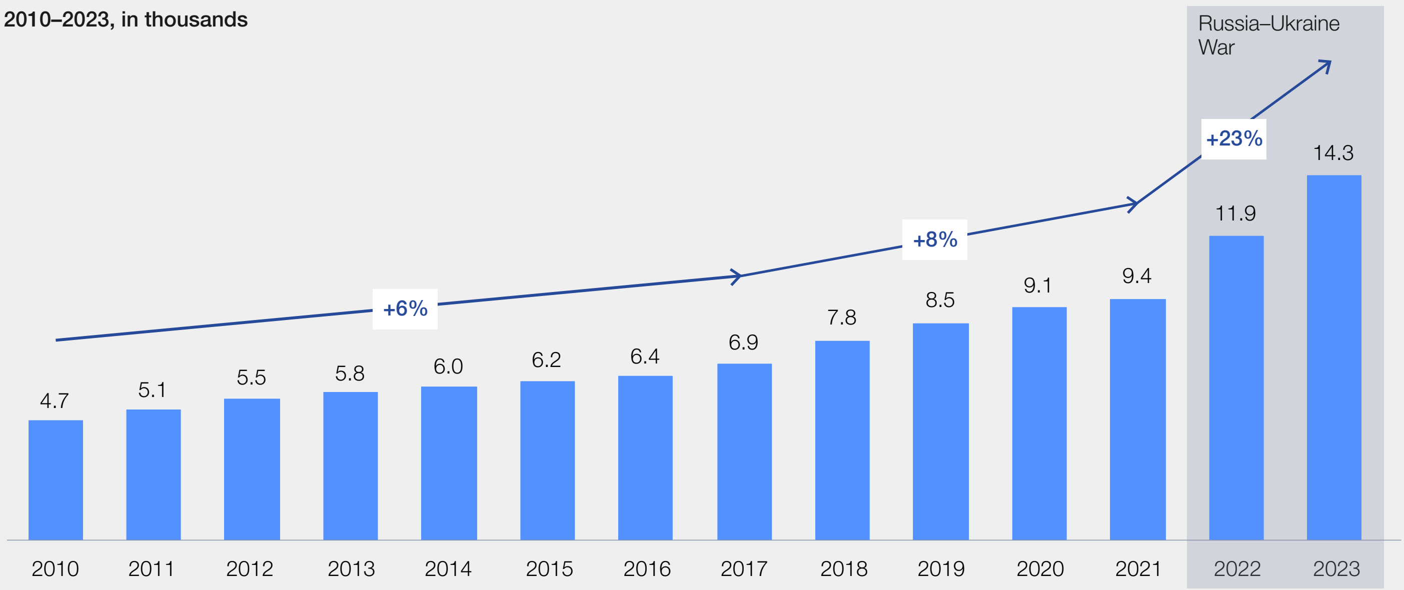
Category	Component	Description	Example
Economic sanctions	**Financial sanctions**	Freezing assets, restricting access to financial markets, prohibiting and blocking transactions	Freezing assets of military officials for human rights abuses
	Travel bans	Denying visas or entry to individuals	Banning visas for officials linked to corruption
	Sectoral sanctions	Sanctions targeting specific sectors	Sanctioning the energy sector for environmental violations
	Secondary sanctions	Penalties on third parties engaging with sanctioned entities	Threatening sanctions on firms trading with a sanctioned nation
Trade policies	**Tariffs**	Taxes on imported goods to protect domestic industries	Imposing tariffs on imported steel to protect local industry
	Quotas	Limits on the quantity of specific goods imported/exported	Setting quotas for dairy imports to support local farmers
	Trade agreements	Bilateral/multilateral agreements to reduce trade barriers	Negotiating a trade deal for economic cooperation
	Anti-dumping measures	Policies to prevent below market-value sales by foreign companies	Enforcing duties on textiles sold below market value
	Subsidies	Financial support for domestic industries	Allocating subsidies for renewable energy projects
Investment controls	**Screening mechanisms**	Review processes for foreign investments based on security and stability	Conducting security reviews of foreign investments
	Ownership restrictions	Limits on foreign ownership in certain industries	Restricting foreign ownership in telecommunications
	Sectoral restrictions	Prohibitions on foreign investment in critical sectors	Banning foreign investment in defence for security reasons
	Performance requirements	Conditions for foreign investors (e.g. technology transfer)	Requiring local partnerships for foreign tech firms
Export controls	**Licensing requirements**	Government approval needed for certain exports	Mandating licences for sensitive technology exports
	Prohibited destinations	Bans on exporting to specific countries/regions	Prohibiting exports to nations under sanctions
	Controlled technologies	Restrictions on advanced technology exports	Limiting dual-use technology exports to prevent military use
	End-use monitoring	Ensuring that exported goods are used as intended	Checking military equipment for compliance with agreements
Aid and assistance	**Development aid**	Financial support for economic development and infrastructure	Providing aid for infrastructure in low-income countries
	Humanitarian aid	Emergency assistance for crises	Delivering aid to communities affected by disasters
	Technical assistance	Expertise and training for governance and capacity-building	Offering training to improve public health systems
	Military aid	Support for defence, including funding and training	Providing military training and equipment to allies facing threats

Source: Oliver Wyman analysis

Economic statecraft can drive fragmentation by directly disrupting the operation of the financial system. For instance, in response to the September 11 attacks, the US government systematically used the global financial system to track and disrupt terrorist financing. The effort to combat terrorist financing was recognized by the international community and became institutionalized via the intergovernmental Financial Action Task Force (FATF). The United States developed sophisticated capabilities to monitor and control international financial flows, which it continued to leverage over the next two decades.[15] The dollar's centrality as a reserve currency gave US policy-makers leverage to advance foreign policy goals through economic tools such as sanctions.

Western sanctions on Russia following its invasion of Ukraine in 2022 represented the most significant escalation in the use of finance to advance geopolitical objectives. The United States, the European Union and other partners froze nearly $300 billion in Russian central bank reserves, compelled financial market infrastructures to disconnect Russian institutions from their systems, cutting off direct access to global financial markets, and implemented debt and equity listing restrictions.

FIGURE 5 **Number of active sanction designations by the US Treasury**



Source: Oliver Wyman Forum x NYSE CEO Survey 2024. Oliver Wyman Forum analysis

While many economic statecraft instruments, including sanctions, are designed to disrupt the economic activities of targeted entities, unintended consequences can exacerbate their impacts. Since geopolitical actions are difficult for financial markets to anticipate and hedge against, they prompt actors to take risk-averse positions. Such behaviours can create further market dislocation and establish negative feedback loops. Targeted investment restrictions can have a similar effect. While these restrictions may not affect investors' returns in the short term, they restrict liquidity and increase capital costs in the long term. Investment restrictions can also go beyond shielding those sensitive sectors, raw materials and companies that policy-makers deem vital for national security or domestic resilience, by impacting a sector's "investability" and affecting asset allocation decisions and investment plans. Economic statecraft measures can therefore have systemic impacts on the global financial system and economy.

1.4 Multipolarity and pressures for fragmentation

Decline in dollar's share of global reserves since 1999.

Fundamental changes to the architecture of the global financial system are both readily observable and accelerating. The dollar's share of global reserves has declined from 71% in 1999 to 58% in 2024, underscoring the ongoing trend towards a more multipolar financial system.[16] At the same time, in response to the COVID-19 shock and subsequent supply-chain disruptions, advanced economies adopted industrial policies to increase the resilience of their domestic economies. Russia's invasion of Ukraine, and the corresponding Western sanctions regimes, acted as a further trigger, accelerating geoeconomic fragmentation and initiating a shift away from the previously globalized economic model.[17] Increasingly, financial system participants are making decisions based not only on maximizing returns but also on geoeconomic considerations.

The rise of industrial policies and nations' growing concern about the self-sufficiency of their economies and financial systems can reduce or redirect cross-border capital flows and increase regulatory divergence. In the past decade or so, all major economic powers have enacted new industrial policies, such as China's Made in China 2025, the Inflation Reduction Act in the United States and the EU's European Chips Act (see Figure 6). While the structure, scale and intent of such policies can vary, they all use a mixture of subsidies, investment restrictions, tariffs and export controls to foster industries or objectives viewed as essential to national interests.[18]

FIGURE 6 **Industrial policies – a deep dive**

Aspect	Made in China 2025	US Inflation Reduction Act	EU European Chips Act	Make in India
Goal	Upgrade China's manufacturing capabilities and reduce foreign tech reliance	Help US to reach climate goals, strengthen energy security and job market, reduce cost of healthcare	Strengthen semiconductor industry in EU by ensuring resilience of supply chains and reducing external dependencies	Boost domestic manufacturing and attract foreign investment
Investment volume	~$300 billion planned investment by 2025	$369 billion allocated for energy and climate initiatives	+€100 billion planned investment including +€43 billion public investments	+$26 billion in incentives across various sectors
Key sectors	Manufacturing, information technology, energy, aerospace and maritime engineering	Energy, manufacturing, healthcare, transportation, agriculture	Semiconductors, information technology	Manufacturing, electronics, textiles, automotive

Source: Griffith Asia Institute. UNCTAD Investment Policy Monitor. Indian Ministry of Commerce & Industry. Oliver Wyman analysis

Technological innovation can also accelerate the trend towards multipolarity. Over 90% of central banks are now exploring CBDCs, which could enable alternative payment channels that bypass traditional fiat-based systems.[19] Examples include China's e-CNY CBDC and the mBridge multi-CBDC platform for cross-border payments, which offer alternative platforms for financial connectivity. If countries begin to adopt wholesale CBDCs without first putting a harmonized and interoperable regulatory framework in place, the global financial system could see the emergence of multiple digital currency ecosystems.[20] This could create a more fragmented international monetary system and pose financial stability risks.[21]

The institutional framework for global governance is also showing signs of strain. Since 2019, the WTO Appellate Body has been unable to issue decisions, resulting in countries pursuing more regional trade agreements, which accelerates the formation of regional trading blocs and drives fragmentation.[22] Similarly, the G20 has faced challenges coordinating global responses on issues ranging from financial governance to the energy transition. Without greater international coordination, other forums such as such as the BRICS Intergovernmental Organization and Group of 7 (G7) may devise separate approaches. Specific examples are mentioned later in this report.

These developments reveal that the success of global financial integration has made the underlying system a powerful geopolitical tool, but its unprecedented efficiency contributes to its vulnerability to the consequences of economic statecraft. Meanwhile, technological innovation offers new possibilities for creating parallel financial systems that could bypass or shift the existing global order. The challenge ahead lies in managing a more multipolar world and increasing fragmentation while still preserving the benefits of global financial integration that have facilitated decades of economic growth.

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2

What are the costs of a fragmented financial system?

A fragmented global financial system can negatively affect GDP and increase inflation, particularly for EMDEs. Policy-makers can help drive economic growth through deepened financial integration.

2.1 Macroeconomic impact

15%

Potential reduction in bilateral cross-border portfolio and bank allocation due to an increase in geopolitical tensions (IMF).

From a macroeconomic perspective, the potential risks and costs of geoeconomic fragmentation are substantial. This report estimates that the global costs of fragmentation could amount to approximately $5.7 trillion or about 5% of current global GDP.

A more fragmented global order will in most instances act as a cost driver. In industries with higher exposure to geoeconomic fragmentation, firms have shifted from "just-in-time" production models to costlier "just-in-case" approaches that diversify portfolios and supply chains. Such measures can increase resilience but also increase costs. Investment restrictions, export controls and tariffs can result in inefficient reorganizations of portfolios and supply chains, increasing global inflation. One illustrative example is a US government rule from October 2024 limiting investment in Chinese high-tech sectors.[23] Another is the Chinese government's export restrictions on rare earth metals and minerals, which are essential to produce high-tech products, including semiconductors and lithium batteries.[24] While these measures may be designed to protect respective national security interests, they can increase costs for consumers and businesses.

Geopolitical pressures can also reduce liquidity throughout the financial system, as nations erect new barriers to foreign exchange markets, cross-border transactions and investment flows. IMF research indicates that a significant increase in geopolitical tensions between two countries can "reduce bilateral cross-border portfolio and bank allocation by about 15%".[25]

Business mitigation strategies: Consider broader risk analysis
Incorporating geoeconomic factors into their non-financial risk assessments allows financial institutions to identify and assess a broader range of risks, enhancing their overall risk management framework.

Regulatory divergence, another potential consequence of geoeconomic fragmentation, can also raise compliance costs for the public and private sector. Growing geopolitical divides make it more difficult for financial governance institutions to share data, improve transparency, harmonize regulations and build trust. Such divergence can drive the growth of parallel but incompatible financial market infrastructures (FMIs), which increases costs and complexity. As geoeconomic competition intensifies, increasing regulatory divergence can lead to the emergence of economic blocs with largely separate payment systems, regulations, supply chains and technology ecosystems.

A major risk to the financial system arises less from the intended policy objectives than from the unintended consequences of policy-driven fragmentation. Recent history presents examples of policy-makers electing to accept fragmentation to advance other goals, such as preventing systemic contagion or insulating supply chains from COVID-19 shocks. Such policies may result in small efficiency losses that policy-makers deem acceptable to ensure the supply of certain critical goods.

However, an unintended consequence of these measures may be a tendency for countries to reorient international trade to focus on geopolitically aligned blocs. This decoupling scenario would pose a significant threat to the global trading system as it currently exists, with potentially significant costs as a percentage of global GDP.[26] From a financial sector perspective, the development of separate technological ecosystems could force multinational financial companies to build costly redundancies to comply with different standards. Similarly, countries might be compelled to align themselves with one of the competing technological standards.

The emergence of economic blocs could shift financial flows, making them more regionally concentrated rather than globally integrated.

Fragmentation also reduces the capacity to share and diversify risks, thereby making the system more vulnerable to shocks.[27] The emergence of economic blocs could shift financial flows, making them more regionally concentrated rather than globally integrated. With fewer opportunities for geographic diversification, investors' portfolios would be limited to certain country blocs and thus more susceptible to shocks. Countries' reliance on bloc-specific currencies could also "complicate the balancing of global financial flows in the long term".[28] A less robust global financial safety net (GFSN) would heighten the likelihood of financial crises and might necessitate central banks in economies with less-developed capital markets to build up costly liquidity and capital buffers.[29] An unstable financial system also increases the risk of price volatility.[30]

Quantitative assessment of global geoeconomic fragmentation costs

To better highlight the risks and costs of a fragmented financial system, this report uses an econometric model to measure the potential macroeconomic impacts of various geoeconomic scenarios. The model measures the impact of geoeconomic fragmentation, broadly (i.e. the impact of fragmentation on the whole economy rather than only the financial system), which includes proxies for financial system fragmentation, specifically, via shocks to productivity, reduced financial flows, etc. The model produces two key findings:

– **Geoeconomic fragmentation has a consistently negative impact on global output.** Analysis in this report suggests that economic output losses could range from **$0.6 trillion to $5.7 trillion**, or about 5% of global gross domestic product (GDP) in the short term. By comparison, the COVID-19 pandemic caused global output losses of approximately 2.5%. In the long term, as economies and financial actors adjust to deeper fragmentation, output losses could be as high as about 4% of global GDP growth.

– **Geoeconomic fragmentation is a driver of inflation.** Inflation rises steadily in most countries as fragmentation increases. A decoupling of the global financial system and economy into two distinct blocs could increase global inflation by **more than 5%**. To manage the inflationary shock, countries would potentially need to raise interest rates and institute monetary tightening. This in turn might affect borrowing costs for individuals, corporations and countries.

This model shows that the greater the geoeconomic fragmentation, the higher the associated impact on financial system participants. The above estimates describe the potential marginal impact on GDP growth and inflation (i.e. by how much growth and inflation deviate from baseline projections). By evaluating different scenarios, from low fragmentation to very high fragmentation, the model highlights that greater reliance on restrictive economic statecraft policies can lead to a larger decline in global GDP.

BOX 2

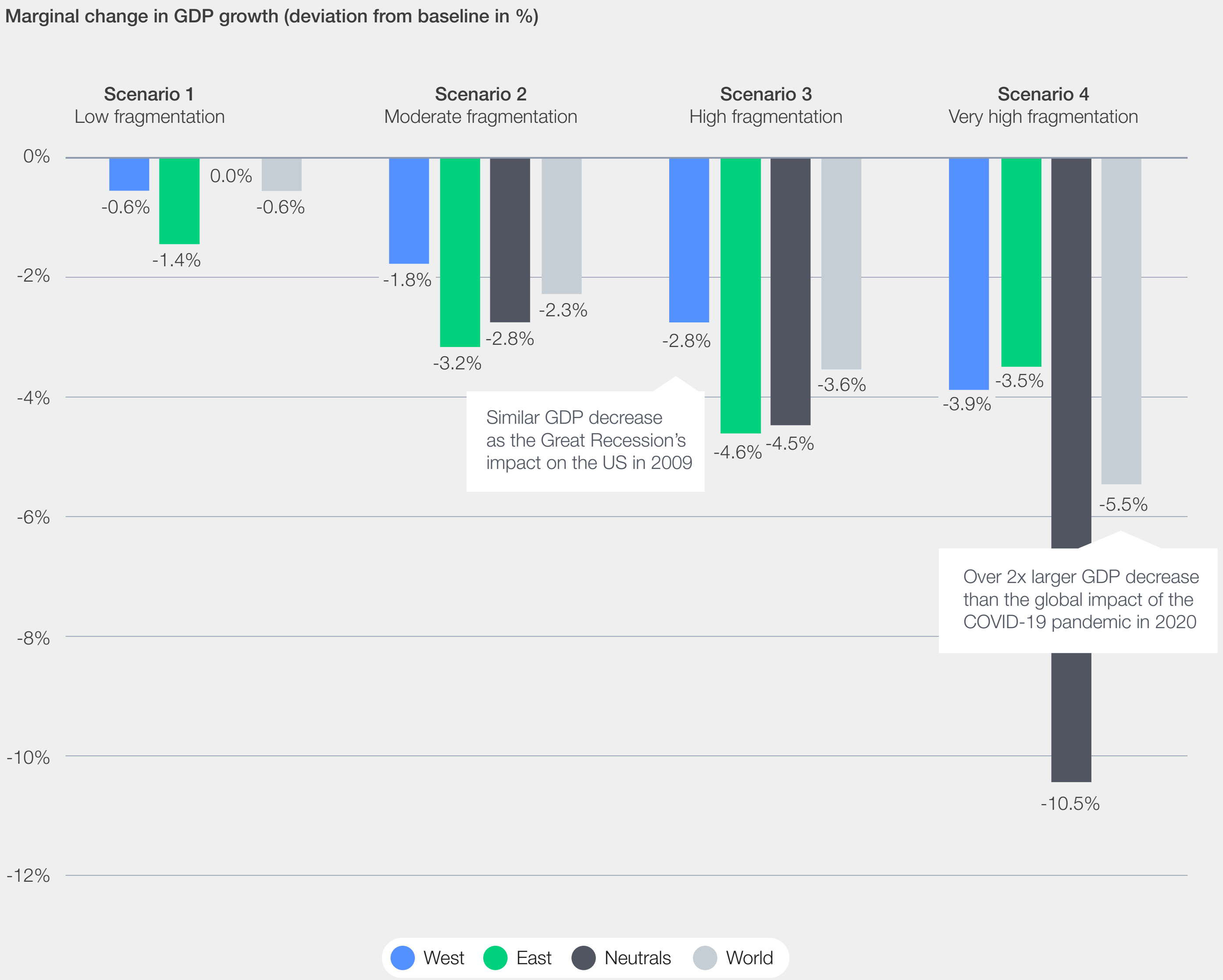
Model details

The analysis employs a multi-country, multisector model that is widely cited and used in academic research. Geoeconomic fragmentation's economic impact is measured using direct and indirect shocks. Direct shocks refer to trade tariffs, whereas indirect shocks encompass negative productivity changes, a possible consequence of more financial friction. Economic impacts are measured at one year and five years after fragmentation begins (i.e. short and long term) and reflect annualized changes in economic output.

This five-year period is chosen because academic research has found that most of the trade adjustments to shocks are completed by year five, and trade elasticity estimates are much more accurate at five years than at 10 years.[31] The model observes an import price shock in the short run affecting inflation. A tariff, or financial friction that reduces productivity, can be inflationary by raising the prices of certain imported and domestically produced goods. However, reallocation of production across countries can offset the potential one-time inflationary effect. For example, reallocation of supply chains and financial flows between countries may reduce or inverse an inflationary impact in a particular country if producers are able to substitute away from that country's domestic producers. The model includes 40 countries, with the remaining financial and production linkages aggregated into a composite "rest of the world" category. Each country is represented by 30 industries, which allows for a nuanced analysis of overall economic output based on individual changes in geoeconomic dynamics.

The model considers four scenarios of increasing severity to show how different levels of fragmentation will affect the global financial system and economy. As fragmentation increases across scenarios, the probability of that scenario occurring decreases. For analysis purposes only, the model assumes that three distinct economic blocs emerge based on today's geopolitical environment: the "West" (the US, the EU, Australia, Canada, Japan, South Korea and the United Kingdom), the "East" (China and Russia) and "Neutrals" (Brazil, India, Indonesia, Mexico, Taiwan, Türkiye and a composite of additional remaining countries).

FIGURE 7 **Short-run impact of financial fragmentation on gross domestic product across geopolitical blocs**



Source: NERA analysis based on the multi-country, multisector model of Baqaee & Farhi (2024).[32] Data from 2013 World Input–Output Database and Asian Development Bank's 2023 Input–Output Tables. Short-run impact is defined as the impact measured one year after the shocks and is based on applying the one-year to 10-year trade elasticity ratio found in Boehm et al. (2023)[33] to the elasticities in Baqaee & Farhi (2024), as in Bolhuis et al. (2023)[34]

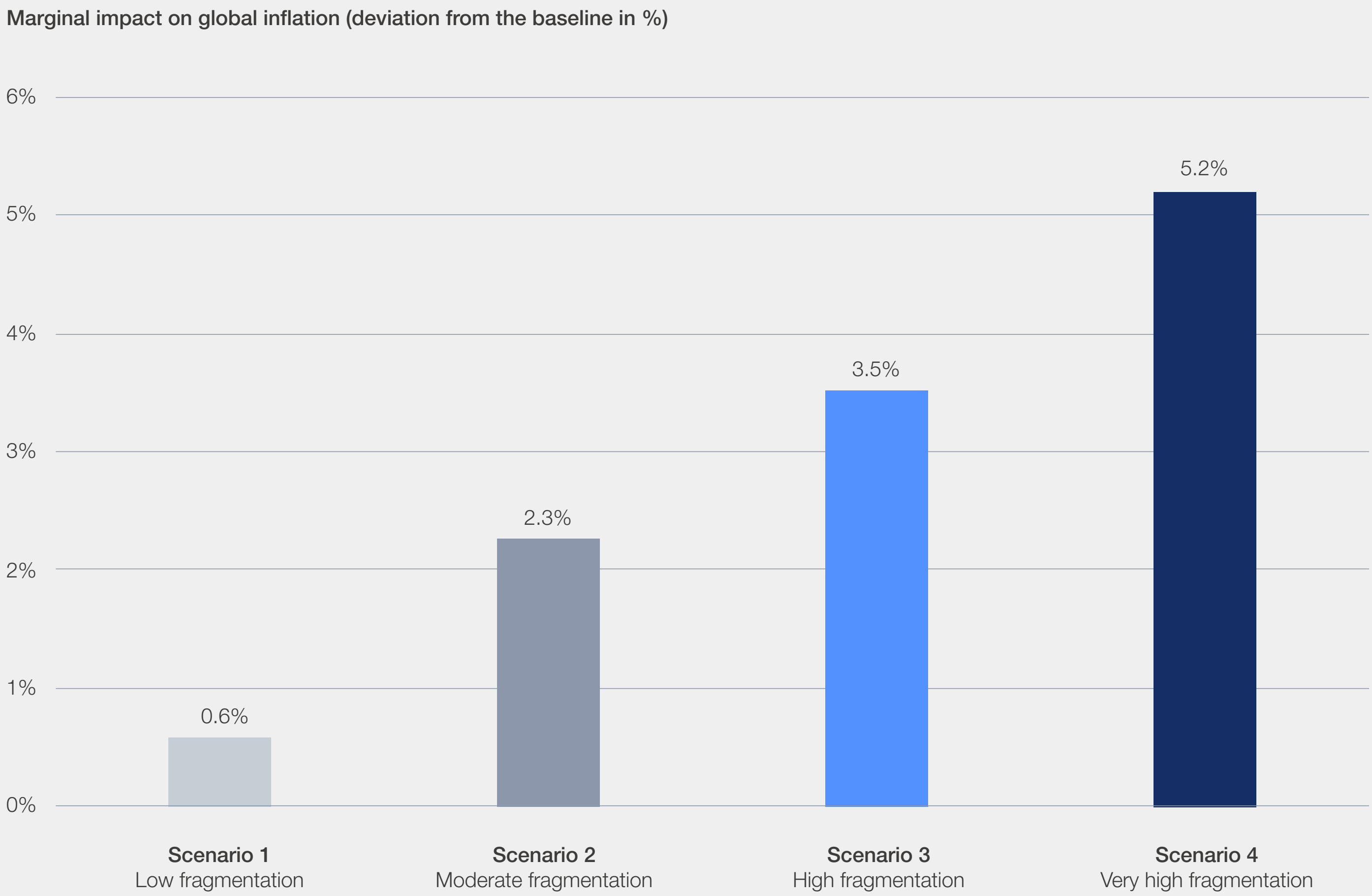
Scenario 1 – Low fragmentation: In this scenario, countries restrict capital and trade flows only in certain sensitive areas and encourage unimpeded activity in all other parts of the economy. The model envisions a ban on trading sensitive technology between the Eastern and Western blocs similar to the "small yard and high fence" approach, which limits investment restrictions to sensitive industries or technologies without impeding capital flows to other parts of the economy.[35] The overall impact on global output is notable, but moderate, at -0.6% after one year. Inflation increases by 0.6% globally.

Scenario 2 – Moderate fragmentation: This scenario introduces economic statecraft restrictions on all economic exchanges between the three blocs, with less severe measures between Neutrals and the other two blocs. Accordingly, the model shows that there are more significant tariff and financial productivity losses, driving a 2.3% decline in global economic growth in the short run. The effect on inflation is also more significant in this scenario, with a projected increase of 2.3%.

Scenario 3 – High fragmentation: This scenario forecasts a financial decoupling that ceases all economic exchanges between Eastern and Western blocs. Neutral countries are subject to moderate restrictions on capital and goods flows but maintain their financial linkages and supply chains with both the East and West. The costs of fragmentation are severe for all three blocs, with global output being reduced by 3.6% in the short run. The Western bloc would see a decrease similar to the impact of the Great Recession on its respective economies. Global inflation is estimated to increase by 3.5%.

Scenario 4 – Very high fragmentation: The worst-case, and least probable, scenario establishes two distinct economic blocs. All financial and economic activity stops between East and West, and the Neutrals are compelled to choose the side of their largest trading partner. The output losses are highest for Neutrals, who are forced to limited economic exchange to counterparts within a single bloc. In the short run, total global output losses reach 5.5% of global GDP, approximately twice as much as during the COVID-19 pandemic, with global inflation rising by 5.2%. For the Eastern bloc, the impact would be deflationary, as weaker demand translates to easing price pressures. The long-term impact on output remains significant at 4.2%.

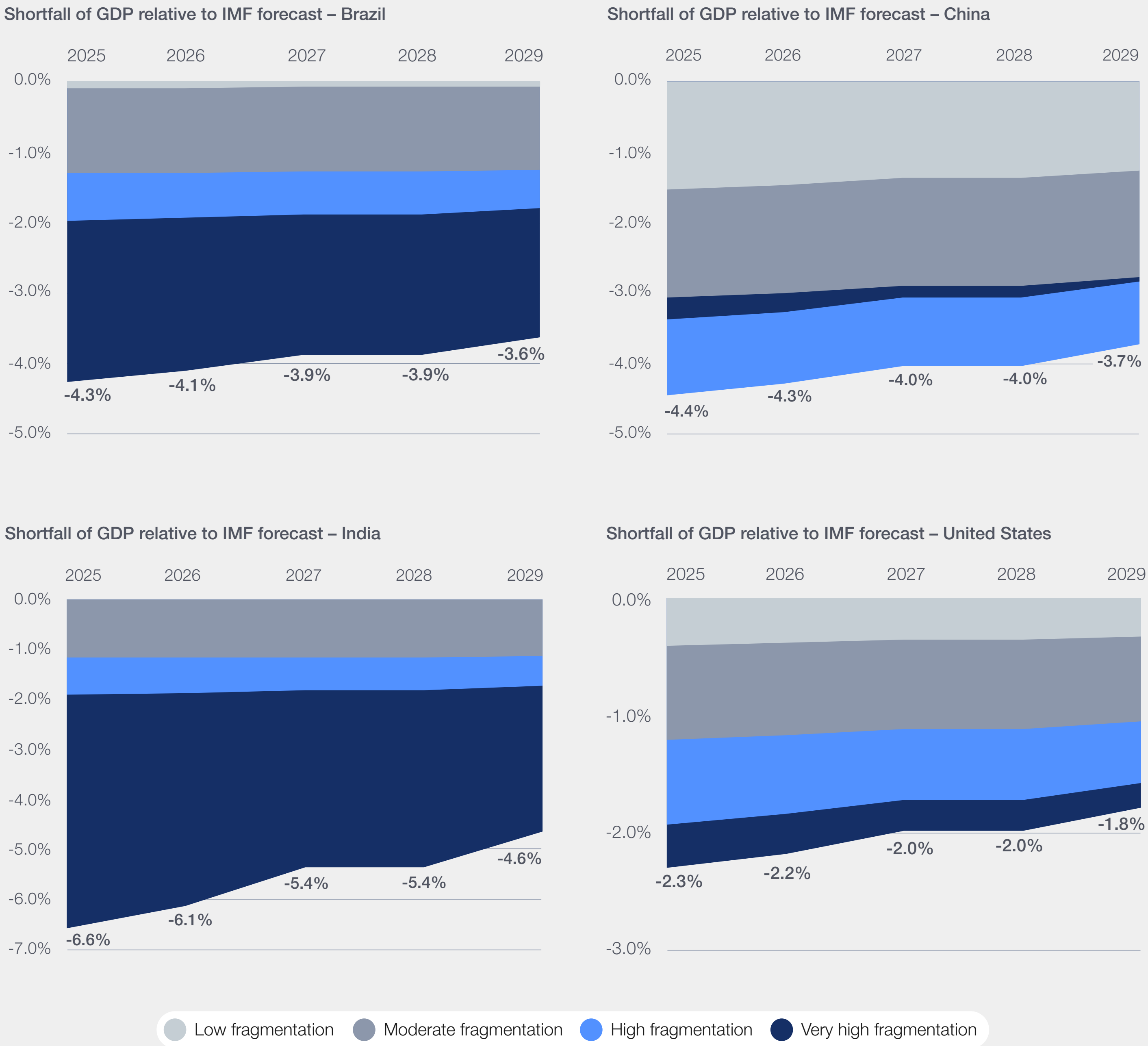
FIGURE 8 **Short-run impact of geoeconomic fragmentation on global inflation**



Source: NERA analysis based on multi-country, multisector model of Baqaee & Farhi (2024).[36] Data from 2013 World Input–Output Database and Asian Development Bank's 2023 Input–Output Tables. Short-run impact is defined as the impact measured one year after the shocks and is based on applying the 1-year to 10-year trade elasticity ratio found in Boehm et al. (2023)[37] to the elasticities in Baqaee & Farhi (2024), as in Bolhuis et al. (2023)[38]

These four scenarios provide estimates for the macroeconomic impact of geoeconomic fragmentation that may change based on different variables, including the resilience of the global financial system. The model serves as a proxy for the different transmission channels, such as regulatory divergence. The country-specific model forecasts for Brazil, China, India and the US show the adjustment to fragmentation over a period of five years. Higher fragmentation provides financial system participants with greater incentives to locate alternative sources of capital or shift to different payment systems to reduce costs in the long term.

FIGURE 9 | **Long-run shortfall of GDP relative to IMF forecast**



Note: Figure shows the projected shortfall of GDP relative to annual IMF Real GDP growth projections.

Source: Based on multi-country multisector model of Baqaee & Farhi (2024).[39] Data from 2013 World Input-Output Database and Asian Development Bank's 2023 Input-Output Tables and IMF. Each year's impact is calculated by applying the ratio of the trade elasticity for the associated number of years since 2024 to the 10-year trade elasticity as found in Boehm et al. (2023) to the elasticities in Baqaee & Farhi (2024)

2.2 Impact on EMDEs

The costs of a fragmented financial system are particularly acute for EMDEs, where capital flows and costs are more influenced by geopolitical factors, potentially jeopardizing their growth prospects and convergence opportunities.[40] Without access to necessary pools of capital and investment, these states may seek financial support outside the international rules-based system, further exacerbating fragmentation.

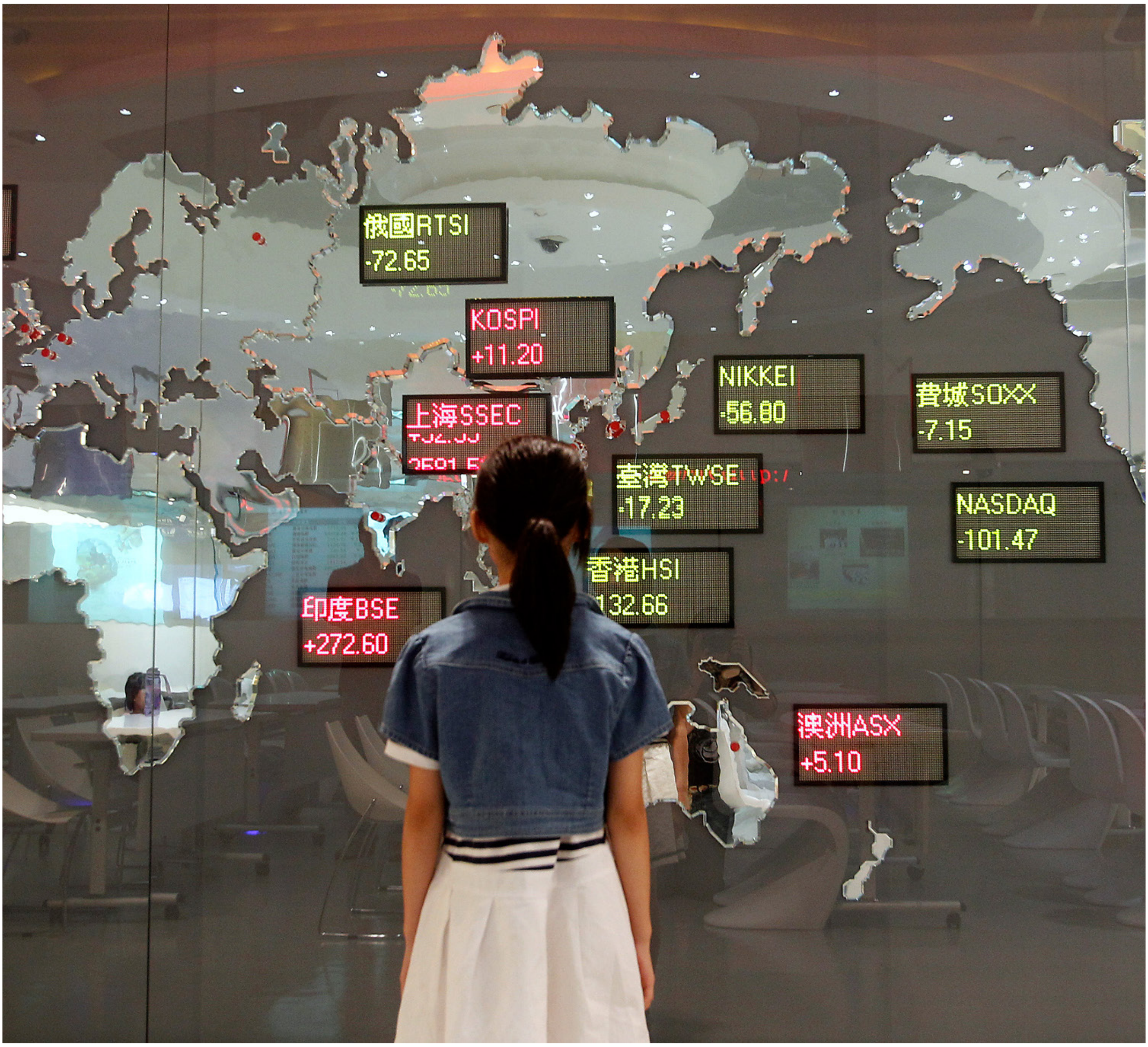
A fragmented financial system could undercut financial stability and hinder coordinated global responses to financial shocks. More fragmentation could mean that EMDEs receive less support during financial crises and encounter greater difficulty achieving sovereign debt relief.[41] In an environment with more and fragmentated creditors, individual creditors might engage in bilateral rather than multilateral negotiations with debtor nations, further complicating the resolution process.

As geopolitical tensions escalate, the likelihood of a sudden stop in capital flows increases.[42] In a system with diminished liquidity, states without robust and well-integrated capital markets may encounter difficulties in securing funding for essential investments, partly due to reduced access to private capital. This includes EMDEs as well as developed regions with fragmented capital markets. The EU's lack of integrated capital markets, as recently highlighted in the Draghi Report, represents a significant hurdle for unlocking more economic dynamism in Europe.[43]

“ Further financial system decoupling would increase the risk of countries and firms getting caught between economic blocs with conflicting regulations and standards.

Current trends indicate that amid rising geoeconomic uncertainty, more investors are directing their capital to advanced economies, especially the United States.[44] In addition, some governments' extraterritorial enforcement of regulations have imposed requirements stricter than local laws, which increases compliance and operating costs for global financial institutions operating abroad. These heightened costs may compel international banks to withdraw from EMDEs, leading to increased financial intermediation costs and diminished financial inclusion in those regions.

Further financial system decoupling would increase the risk of countries and firms getting caught between economic blocs with conflicting regulations and standards. Fragmentation might also impede multilateral collaboration on challenges where collective action is essential, such as the energy transition and EMDE debt relief. The report's quantitative analysis shows that non-aligned countries would likely suffer the highest negative costs, as they are forced to choose one bloc as a trading partner and are impeded in accessing advanced technology and research and development.[45]



2.3 Impact on financial institutions

A more fragmented financial system exposes private financial actors, including banks, hedge funds and institutional investors, to all of the previously mentioned macroeconomic costs and risks. Higher inflation and regulatory divergence not only decrease corporate margins, but policy uncertainty also creates pressures for the private sector to focus on shorter-term opportunities and outputs at the expense of more strategic, long-term planning. By threatening many of the key tenets of long-term, prudent investing, including universal respect for property ownership and the ability to invest across borders, fragmentation may necessitate higher returns for investors or reduce cross-border flows. Companies are forced to weigh return and business considerations against changing geopolitical trends and their associated risks and costs (e.g. compliance costs).[46]

Business mitigation strategies: Use scenario analysis
By conducting scenario analysis, financial institutions can swiftly respond to ad-hoc changes in the geopolitical landscape and adjust strategies in real time.

Geoeconomic policies that weaken financial stability or prompt asset reallocations may also reduce the ability of banks and other non-bank financial institutions to facilitate financial intermediation.[47] This example underscores how the costs of financial fragmentation, such as reduced bank lending, can cascade through the economy.

BOX 3

Investing in a multipolar world

Fragmentation of the global financial system has led to increased tariffs, economic sanctions and export controls complicating deal-making and heightening the risks associated with cross-border investments. In 2023, the Organisation for Economic Co-operation and Development (OECD) reported a significant rise in foreign investment regulations, with 80% of the 61 reporting economies implementing screening mechanisms, leading to prolonged transaction timelines and heightened uncertainty. Investment restrictions and varying regulatory criteria across jurisdictions create complexities in assessing strategic sectors as financial outcomes must now be weighed against geopolitical risks. This has prompted a shift towards investments in domestic markets with lower geopolitical sensitivity and reduced global supply-chain entanglements. Investors, such as Temasek, have established policy and governance teams in key global capitals to build a resilient portfolio that balances risk and compelling opportunities.

Table 2 outlines the key risks and costs of a fragmented global financial system for financial institutions as well as how they might significantly affect an institution's strategic planning, operational efficiency and overall competitiveness. These challenges necessitate careful consideration and strategic adaptation to navigate the evolving financial landscape.

TABLE 2 **The potential costs and risks for firms of a more fragmented financial future**

Impact on private financial institutions' risk management
Counterparty risk Financial institutions (FIs) could have fewer options for risk-sharing, capital sourcing and transacting, increasing overall counterparty risk
Credit risk Investors and ratings agencies may re-evaluate debt profiles across various jurisdictions and blocs, impacting the credit risk of corporates and governments
Currency risk The rise of competing international reserve currencies might increase currency instability
Investment execution risk Restrictions on capital flows, listings and cross-border asset ownership, as well as the risk of government seizures, forced sales and reduced market discipline, could affect investors' ability to execute investment strategies and realize returns
Liquidity and solvency risk To safeguard against shocks, FIs might hold larger reserves on their books to manage liquidity and solvency risks
Market access risk/opportunity costs Economic sanctions and/or other measures could prohibit investors and companies from entering certain markets
Regulatory requirements Geopolitical volatility could force governments to impose further capital, liquidity or stress-testing requirements
Reputational risk FIs and corporates with exposure to non-aligned countries and blocs, or even non-cooperative firms and sectors, could see reputational risks with the public and their governments
Risk management Fragmentation may incentivize FIs to focus domestically or within aligned blocs, limiting their ability or desire to manage risk through diversification
Valuation risk Geopolitical pressure may weaken investor appetite, thereby limiting deal opportunities, reducing liquidity, causing asset-stranding and increasing valuation volatility

Source: World Economic Forum and Oliver Wyman

CASE STUDY 1

Geoeconomic tensions impede investment exit strategies

Introduction: As regulatory environments tighten and geopolitical tensions rise, public pension plans and private equity firms are re-evaluating their strategies regarding China-focused funds. US institutions with significant private fund investments in China are facing increasing difficulties in exiting their investments.[48]

Changing regulatory landscape: US pension plans, with over $4 billion allocated to China-focused private equity, are delaying redemptions as their investments and funds approach the end of their 10-year lifespans. The regulatory environment has shifted dramatically, particularly following the delisting of Didi from the New York Stock Exchange in 2022, which has dampened US initial public offerings (IPOs) of Chinese companies. The introduction of US legislation requiring ByteDance to divest its TikTok operations has further complicated exit strategies for US-backed private funds, raising fears of diminished valuations.

Decline in investment activity: Historically, US private equity funds were active in China, investing heavily in its consumer and internet sectors. However, investment from US funds fell by 68% in 2022, with only five Chinese companies backed by US private equity going public in New York since early 2022, a stark decline from the 18 in 2021, alone. The combination of the Federal Reserve's interest rate hikes and new regulatory requirements effectively stalled potential IPOs, leaving investors with limited exit options.

Implications for investors: The inability to exit investments has serious implications for foreign pension plans and private equity firms. As funds approach liquidation timelines, concerns grow over the lack of liquidity and the potential need to extend investment durations. Investors are left with few choices, often resorting to rolling over their investments in the hope that the IPO market will eventually reopen. The performance of China-focused funds has also suffered, with benchmarks such as the Warburg Pincus China fund experiencing a significant drop in internal rates of return. The landscape for foreign private equity investments in China is increasingly fraught with challenges. Regulatory changes, geopolitical tensions and a stagnant IPO market have created a complex environment for investors. As they navigate these difficulties, many financial actors are left with little choice but to extend their investment horizons while hoping for a more favourable exit climate in the future.

CASE STUDY 2

Growth of emerging market currencies

Introduction: Foreign exchange (FX) settlement risk captures the risk that one party delivers the currency it sold but does not receive the currency it bought, resulting in a loss of principal. In order to mitigate FX settlement risk on a global scale, the private sector established CLS in 2002 as a response to public-sector calls. Today, on average, more than $7.2 trillion in 18 of the most actively traded currencies flows through CLS each day. CLS mitigates FX settlement risk by synchronizing the settlement of payment instructions for the two currency legs of an FX trade. It does this by providing payment-versus-payment (PvP) functionality in which a party's payment instruction in one currency is not settled unless the corresponding payment instruction in the counter currency is settled. PvP's importance is widely recognized by public- and private-sector initiatives such as the BCBS, which recommends using PvP settlement where practical; the G20 Roadmap for enhancing cross-border payments, which inter alia aims to facilitate increased adoption of PvP; and the FX Global Code.

Growth of emerging market currencies comes with growth of FX settlement risk: According to the 2022 BIS Triennial Survey, the FX market turnover has multiplied by a factor of five over the past decades, from around $1.5 trillion to approximately $7.5 trillion per day. Throughout its evolution, several key currencies have comprised the bulk of FX trading, dominated by the US dollar, which facilitated offshore funding markets and serves as a base currency through which other currencies are exchanged indirectly. The Chinese renminbi's share of the FX market has grown from 1% 20 years ago to 7% today, making it the fifth most actively traded currency. Overall, the growth in EM currency trading creates opportunities, but also increases challenges regarding higher systemic risk exposure, less efficient capital allocation and higher settlement risks for market participants. The BIS Triennial Survey found that the non-PvP share in overall FX turnover is approximately 22%, largely attributed to EM currencies.

Solutions are needed to further mitigate FX settlement risk: According to the BIS Triennial Survey, the average daily turnover of non-CLS-eligible currencies more than tripled from $0.2 trillion in 2010 to $0.7 trillion in 2022, while the share grew from 5.5% of trades to 8.5%. Adding new currencies to CLS's settlement service is a complex endeavour, requiring ongoing support from central banks on both sides of the currency flow, and crucial legal, risk and liquidity standards must be met in the jurisdiction of onboarding. Beyond PvP, CLS is exploring the possibility that EM currencies can benefits further from CLSNet, an automated bilateral payment netting calculation service across 120 currencies.

3 Guardrails to protect the global financial system

The principles and rules of engagement laid out in this report establish a framework under which the global financial system can continue to contribute to prosperity while respecting national sovereignty.

Implementing safeguards can help protect the financial system's integrity and avoid more severe consequences of excessive fragmentation without undermining state sovereignty; this report proposes two sets of safeguarding frameworks. The first framework, the Principles to Safeguard the Global Financial System from Fragmentation, establishes the core conditions necessary for maintaining essential financial systems operations and market confidence. The second, the Rules of Engagement for Responsible Economic Statecraft, lays out parameters for policy-makers and public-sector institutions to implement geoeconomic policies while still ensuring the stable operation of the global financial system.

3.1 Principles to Safeguard the Global Financial System from Fragmentation

Violating the core principles would represent a threat to the integrity of the global financial system.

The following are the core principles on which financial services actors rely to conduct business across jurisdictions; violating them would represent a threat to the integrity of the global financial system.

1. **Clearly define and uphold the rule of law** to ensure impartial enforcement and predictability across the financial system

The rule of law is the fundamental building block that supports the functioning of the global financial system. A sound legal system, legislative consistency, independent courts and regulatory autonomy are essential parts of a stable legal infrastructure that facilitates trust and predictability among financial market participants.[49] The historical relationship between strong legal frameworks and the US dollar's central role in global finance demonstrates that predictable rule enforcement underpins financial system stability.

2. **Respect financial and physical property ownership rights** to maintain trust and encourage investment, thereby fostering financial stability

Private property rights align creditors' and debtors' incentives to keep the global financial system functioning smoothly. A government's commitment to upholding these rights ensures that, when necessary, property seizures follow rigorous and transparent protocols and that such seizures represent exceptions to the orderly conduct of markets. Precise definitions and articulations about the cause of such seizures can signal that governments respect property rights and resort to seizure based on clear, transparent processes only. Such a foundation gives investors the confidence to accurately value assets, hold property across borders and operate consistently across the globe.

3. **Avoid unilaterally expropriating sovereign assets** even during times of heightened tensions or conflict

Sovereign assets, in particular central bank reserves, help countries "protect against economic shocks" and support the stability of the global financial system.[50] Where possible, policy-makers should consider exempting such reserves from permanent seizure or expropriation via unilateral economic statecraft to better protect the system's integrity. Affirming a commitment to protect such assets helps policy-makers establish a set of norms and draw red lines that define the boundaries of appropriate conduct for economic policies.

BOX 4 | **Managing frozen assets**

US and European leaders deliberated whether to permanently seize nearly $300 billion in frozen Russian central bank reserves in 2023. The deliberations raised concern among some other nations, including Saudi Arabia, about whether their central bank reserves might be similarly vulnerable. Reporting suggested that one Saudi strategy to insulate its reserves would have involved reducing US dollar and euro holdings – measures that would have deepened fragmentation.[51] Rather than seize the Russian central bank reserves, the G7 leaders opted to collateralize the future interest earnings on the frozen Russian reserves to finance a $50 billion loan to Ukraine.[52]

Policy measures that sever financial system payment rails could make it hard to lower cross-border payment costs in line with the G20 Cross-Border Payments Roadmap

4. **Safeguard independence and bolster the capabilities of international institutions, such as standard-setting bodies,** to preserve their role in global financial governance

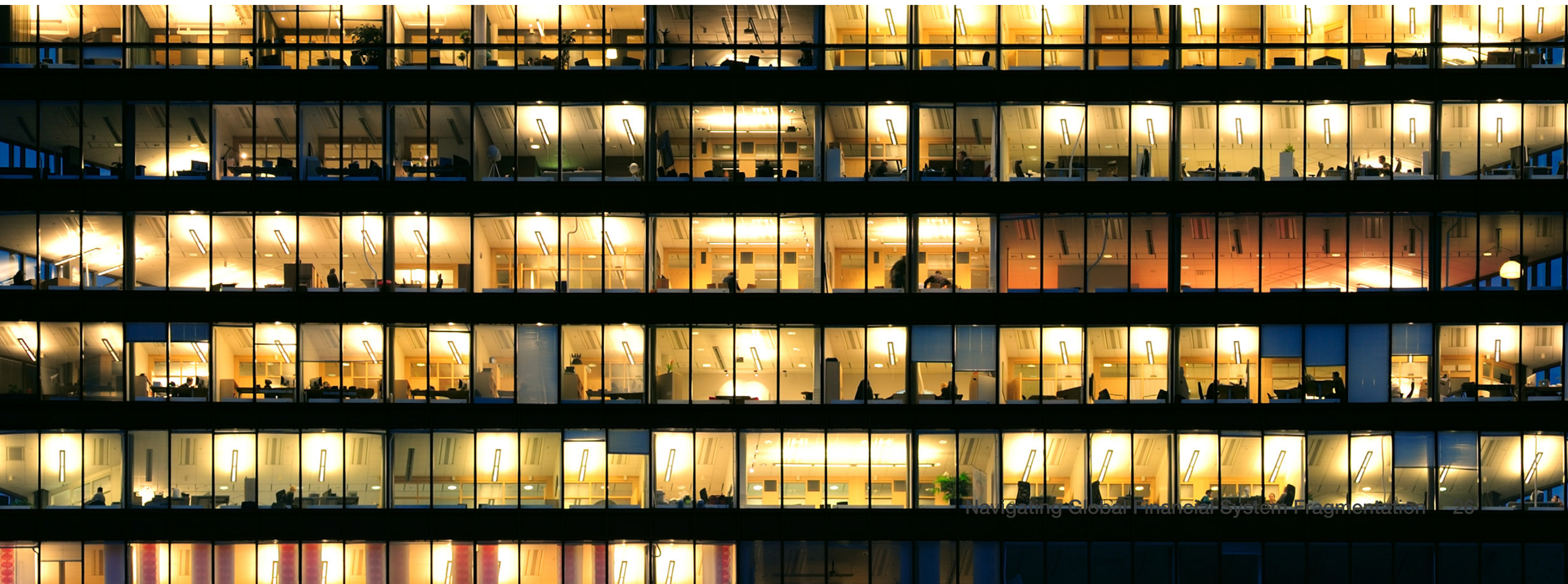
International financial institutions (IFIs) provide many of the linkages holding the global financial system together. Independent global financial governance supported by standard-setting bodies, such as the CPMI, International Organization of Securities Commissions (IOSCO) and FSB, creates a predictable environment that enables financial actors to conduct long-term strategic planning. To maintain public trust, IFIs must demonstrate robust accountability through public consultation processes, detailed disclosure of decision-making procedures, stronger channels for stakeholder feedback and dispute resolution. Such measures help sustain confidence in the neutrality of IFIs, even during periods of geopolitical tension.[53]

5. **Regulate and manage critical financial market infrastructures, but avoid politicizing or severing the underlying financial rails,** given that these systems are essential for maintaining the integrity, functionality and efficiency of the financial system

As the engine room of the global financial system, FMIs facilitate payments, settle and clear transactions, and manage securities deposits. Governmental interference in FMIs' work can degrade their functionality and reduce the efficiency of the overall financial system. Legacy FMIs process a large majority of the financial system's "traffic". The SWIFT interbank messaging system, for instance, handled about 90% of global payment messages in 2020.[54] While policy-makers should be empowered to regulate and monitor the activities that occur on financial system payment rails, including imposing sanctions, it is important to recognize that doing so may produce unintended consequences. For instance, policy measures that sever financial system payment rails could make it hard to lower cross-border payment costs in line with the G20 Cross-Border Payments Roadmap.

BOX 5 | **Institutional fragmentation**

US and EU responses to Russia's attack on Ukraine in 2022 brought questions about control of FMIs to the fore for some nations. After EU regulations disconnected several Russian banks from SWIFT, the use of alternative domestic infrastructures to process payments in Russia intensified. Russia's System for Transfer of Financial Messages (SPFS), created in 2014, saw a 400% increase in annual transactions between 2022 and 2023.[55] Discussions regarding a digital currency mechanism to enable cross-border payments received widespread attention at the BRICS Summit in 2024.[56]



6. **Ensure that parallel financial market infrastructures are interoperable** to facilitate optimal transactions and market efficiency

With geopolitical tensions on the rise, proposals such as a new cross-border digital currency payment mechanism developed by the BRICS countries could signal the beginning of a broader trend among countries "seeking to reduce their dependency on Western payment systems".[57] To prevent the emergence of distinct financial blocs operating on separate payment rails, it is critical that new FMIs are interoperable and also preserve interoperability with new and existing systems. Policy-makers and stakeholders could proactively leverage the existing financial governance systems, develop standardized protocols for data and transaction exchanges, ensure the interoperability of frameworks and implement mechanisms for ongoing monitoring of the infrastructures. The G20's Roadmap for Enhancing Cross-Border Payments represents one ongoing policy effort to ensure such interoperability.

7. **Structure domestic and multilateral policies and financial regulations to support financial stability and ensure cross-border flows** of capital, data, goods, people and ideas

In today's interconnected financial landscape, regulatory and monetary policy decisions typically have ripple effects far beyond the boundaries of any single country. Protecting this interconnected financial landscape carries upsides for governments and the private sector alike, including access to a global financial safety net that can enhance resilience against shocks. To safeguard the continuous operation of this system, governments can develop mutual recognition mechanisms that, where possible, align new regulations and emerging policies with international norms and existing standards. This may help avoid the emergence of an incoherent patchwork of conflicting and overlapping policies worldwide as well as the risk of extraterritorial enforcement. Integrating new technologies, digital assets and fintech into the existing regulatory landscape can ensure that the financial system remains adaptive and forward-looking.[58]

8. **Shield the independence of fiscal and monetary policy** to promote financial stability, reduce the risk of competitive interference and increase opportunities for transparent decision-making

Divergence between monetary and fiscal policies may result in diminished trust and stability within the financial system. Given concerns that greater fragmentation could drive inflation, nations will need robust monetary policy measures to maintain financial stability. Policy-makers can support the independence of central banks and foster greater policy cohesion among them.[59] This can be achieved through coordination and increased dialogue facilitated by institutions like the BIS. Without such transparency and regularized communication – the US Federal Reserve's Jackson Hole Economic Symposium and G20 central bank meetings are examples of existing fora – costly miscalculations can increase the risk of escalatory spirals, such as competitive devaluations.

3.2 Rules of Engagement for Responsible Economic Statecraft

> The rules of engagement aim to assist policy-makers in balancing the unintended consequences of geoeconomic statecraft and excessive fragmentation with the safeguarding of national security and sovereignty.

In the current geopolitical environment, complete regulatory harmonization is unlikely and a certain degree of fragmentation will probably persist. Nevertheless, policy-makers can strive to design geoeconomic statecraft policies that do not result in excessive fragmentation. The following rules of engagement are intended to assist policy-makers in balancing the unintended consequences of geoeconomic statecraft and excessive fragmentation with safeguarding national security and sovereignty.

1. **Design and implement targeted and well-aligned statecraft measures** to minimize the risk of unintended consequences and reduce the private sector's administrative burden (e.g. carry out cost-benefit analyses, provide clear implementation guidance, and assess and reinforce existing regimes)

Economic statecraft measures designed to disrupt global capital flows or sever payment connections can also have unintended consequences. For example, when the United States sanctioned the Russian firm Rusal in 2018, then the second largest producer of aluminium in the world, the measures disrupted global aluminium trade, which caused aluminium prices on commodity markets to surge to seven-year highs and impacted downstream consumers.[60] This example also shows that financial markets are fundamentally interwoven with the real economy – financial fragmentation inevitably affects all global trade flows, raising costs for market participants and undermining investor confidence.

FIGURE 10 **Designing targeted economic statecraft measures**

Source: Oliver Wyman analysis

To minimize unintended consequences, policy-makers can adopt ex-ante measures, such as:

– Defining specific areas for imposing restrictions within the real economy and domestic financial markets, such as the US proposal to adopt a "small yard and high fence" approach

– Conducting cost-benefit analyses to anticipate possible financial and sectoral spillover effects, evaluating likely effectiveness and implementation feasibility, and determining whether existing statecraft measures can be adapted instead of introducing new measures

– Aligning economic statecraft measures on the broadest possible multilateral basis across design, implementation and enforcement by establishing intergovernmental "statecraft taskforces" to oversee policy design, develop real-time information exchanges and agree on standard implementation and enforcement protocols

BOX 6 **Emerging alignment**

The Committee on Foreign Investment in the United States (CFIUS), which administers the US government's inbound investment screening mechanism, has set up new working groups with the EU and Mexico to better coordinate their respective investment screening regimes. Establishing permanent fora to exchange information and best practices can help close enforcement gaps, reduce compliance costs for the private sector and foster investment.

2. **Establish public–private consultation mechanisms to promote transparency in decision-making** regarding the impact of economic statecraft measures on the financial system

Developing public–private consultation mechanisms could provide greater transparency, clarity and consistency about economic statecraft measures. Such channels could have three specific goals:

- Providing clear and exhaustive guidance to private-sector entities about how to implement statecraft measures, such as identifying the individual and entity whose assets a bank must freeze
- Establishing a standing feedback cycle between policy-makers and financial institutions to manage questions and challenges, flag inconsistent policy directives and help policy-makers prioritize competing directives[61]
- Creating public–private advisory committees for finance ministries and sector-specific working groups to facilitate ongoing exchanges, etc.

Business mitigation strategies: Participate in feedback mechanisms
Active participation in discussions with policy-makers can allow financial institutions to highlight potential blind spots and unintended consequences of regulatory actions, promoting more informed decision-making.

3. **Protect populations, sectors, industries and supply chains for humanitarian purposes** through exemptions and carve-outs to avoid collateral damage and ensure their continued access to the global financial system

Exemptions and carve-outs can help policy-makers adopt statecraft measures that accomplish political goals while still mitigating harms to the most at-risk populations. Before implementing new statecraft measures, policy-makers can identify those sectors, industries and supply chains that would likely be subject to spillovers or private-sector derisking practices. Policy-makers can also create explicit carve-outs for the relevant areas before deploying the statecraft measures. Standardized guidelines could identify exempt sectors and promote other tools, such as financial assistance, capacity-building and technical support, to shield vulnerable actors in the global financial system.[62]

BOX 7

Constructive carve-outs

The United Nations developed a model for carve-outs to sanctions by creating a “humanitarian exemption” that authorized humanitarian agencies to pay sanctioned entities for procuring essential supplies, such as food and medicine. A 2023 UN resolution authorized payments “necessary to ensure the timely delivery of humanitarian assistance”.[63]

Combating financial crime, disrupting terrorist financing and financing the energy transition are global financial challenges that are recognized to require collective action

4. **Prioritize the use of economic inducements**, including trade agreements compliant with international law, and other financial instruments that foster mutual gain and cooperation over those designed to cause economic pain

Infrastructure finance and other financial instruments can advance political objectives through cooperation and mutual gain, rather than by imposing economic harms. Promoting debt relief, trade, development, technical assistance, grants, aid and public–private partnerships are only some of the different ways to offer economic inducements. The US used economic inducements in its United States Marshall Plan, which helped rebuild Western Europe after the Second World War.[64] By modelling policy alternatives, governments can minimize their use of punitive tools in favour of more cooperative measures. The first step is to determine whether there is a way to achieve or surpass the intended policy objective through inducements rather than a measure that disrupts economic activity. If this is not possible, policy-makers should assess whether and how it might be possible to accompany a disruptive measure with, for example, inducements to protect vulnerable industries.

5. **Collaborate on areas of geoeconomic consensus**, including combating financial crime, terrorist financing and the energy transition, recognizing the need for collective action to address these global financial challenges

Combating financial crime, disrupting terrorist financing and financing the energy transition are global financial challenges that are recognized as requiring collective action. Greater fragmentation of the global financial system enhances the urgent need for global cooperation. Intergovernmental international organizations, such as FATF, facilitate such collaboration around financial crimes by "establishing international standards and performing reviews to assess nations' compliance with anti-money laundering/combating the financing of terrorism (AML/CFT) procedures".[65] It is vital that such institutions continue to operate with integrity and autonomy, regardless of geopolitical relationships.

BOX 8

Honing collaboration

The embezzlement of funds from Malaysia's sovereign wealth fund, 1Malaysia Development Berhad, has led to strengthened cross-border cooperation among financial regulators from Malaysia, Singapore the US and other countries to combat money laundering more effectively in the future.[66]

6. **Promote global financial stability through heightened coordination among major financial powers** via transparent data sharing and inclusive decision-making to minimize negative spillovers and prevent system fragmentation

Transparent data sharing and inclusive decision-making are mechanisms to enhance stability, regardless of geopolitical context. Global financial powers, including the United States, China, the EU and India, can safeguard the financial system's stability through more effective coordination. G20 ministerial meetings, the IMF and working-level bodies, including the BCBS, represent coordinating institutions that can offset the risk of geoeconomic-driven fragmentation and facilitate multilateral efforts.

BOX 9

Coordination in practice

In November 2023, a ransomware attack on a major Chinese bank "disrupted trading in the US$25 trillion Treasury market".[67] The attack demonstrated how existing intergovernmental communication channels could facilitate ad-hoc crisis coordination and mitigation. Chinese and US policy-makers aligned their responses in bilateral calls and worked closely with the relevant regulators and affected banks to prevent significant financial spillovers from the ransomware attack.

7. **Reform the global financial system to reflect 21st-century geopolitical and macroeconomic dynamics and provide greater benefits to EMDEs**, promoting inclusive economic growth and stability

The global economic landscape is shifting, with Asia driving an increasing share of GDP growth and nine African countries ranking among the world's 20 fastest-growing economies in 2024.[68] While some emerging economies have benefited substantially from the global financial architecture of the past 50 years, many EMDEs remain disadvantaged by high capital costs and debt burdens, and financial system fragmentation will likely affect them disproportionately. Given these dynamics, adapting the global financial architecture to better serve EMDEs is both ethically prudent and structurally necessary. Key reforms could include expanding EMDEs' access to capital, potentially "unlocking $500 billion" annually through reform of the multilateral development banks (MDBs).[69] Other changes might include increasing their representation in global financial institutions and strengthening their domestic financial infrastructure through targeted capacity-building.[70]

8. **Protect the ability of firms to engage with actors across the geopolitical spectrum** by structuring economic statecraft measures, standards and regulations on a multilateral basis, whenever possible

Given that a certain degree of financial system fragmentation is likely to persist, financial institutions, including those in ascendent powers such as Brazil, Indonesia, Nigeria, Saudi Arabia and Türkiye, will want to continue to conduct business with counterparties and in countries across geopolitical blocs. This is true for large multinationals as well as small and medium-sized enterprises that lack the financial and subject matter expertise to navigate these complexities. To prevent a full decoupling of the global financial system into competing blocs, policy-makers should craft economic statecraft measures on a multilateral basis, building the broadest possible geopolitical coalitions. This will prevent third-party and domestic actors with legitimate business interests across jurisdictions from being unduly forced to sever their economic ties and choose between geopolitical rivals.. Policy-makers can revitalize the WTO and strengthen the global economic and financial regulatory landscape, including the G20, BIS, FSB and IOSCO, to safeguard countries' "policy space, sovereignty and economic strength".[71]

3.3 A positive vision for the financial system

The financial sector will become increasingly important in the years ahead, serving as an essential bedrock for collaboration and joint problem-solving, regardless of the geopolitical landscape.

Financial integration has been the global economy's growth engine for the past 75 years. Capital flows facilitate the exchange of goods and services, as well as the dissemination of new technologies, human capital and knowledge. This report's quantitative analysis indicates that a future of fragmentation in the financial sector could erode such positive gains, whereas safeguarding interconnection can support global GDP growth.

The analysis suggests that the financial sector's role as an engine of global growth will become increasingly important in the years ahead, because it provides an essential framework for collaboration and joint problem-solving, regardless of the geopolitical landscape. Even amid geopolitical tensions or wars, global actors need mechanisms for financial exchange. Financial intermediation is driven by economic incentives, such as diversifying portfolios and hedging risks. As such, it offers a powerful tool for bringing actors together to address shared challenges, such as the energy and digital transitions, ageing populations and infrastructure investment, all of which require collective action.

Policy-makers can support this positive vision for the financial system by leveraging cooperation around areas of broad geoeconomic consensus, such as combating money laundering and terrorist financing. Regularized interactions and shared wins around these themes can create momentum for deeper cooperation in more contentious areas. For example, the FATF's success in fostering trust and transparency among policy-makers to counter financial crime could serve as a foundation for further initiatives. In instances where multilateral collaboration is not feasible, plurilateral initiatives offer a viable alternative. Such efforts mobilize a group of economies to provide benefits to all financial system actors.

Positive economic statecraft measures can facilitate investment flows and increase regulatory harmonization. Such integration can lead to increased economic growth as businesses gain access to larger markets, consumers benefit from a wider range of goods and services, and cross-border cooperation accelerates innovation. This would also align broader ambitions of reducing costs for financial actors and increasing the financial system's effectiveness by promoting greater regulatory interoperability. Ultimately, positive economic statecraft can help lay the foundation for sustainable economic development and resilience in the global economy.

4

Policy recommendations: A framework for action

The recommendations in this section provide practical guidance for policy-makers.

This report's policy recommendations provide a practical guide for policy-makers to action the principles and rules outlined in the previous section. In the short to medium term, policy-driven geoeconomic fragmentation will likely remain and may increase further. This section outlines concrete actions to ensure that the core principles underpinning the operations of the financial system remain intact. The interventions and recommendations are organized into three tiers of action, based on the time horizon and fragmentation levels.

The first tier – contending with existing fragmentation – acknowledges that some degree of fragmentation is likely inevitable. Coordinated management of this process can prevent systemic disruption. The second tier of responses – resisting further fragmentation – focuses on preventing divisions from becoming permanent fractures and maintaining connections where possible. Finally, the third tier – reforming the system – recognizes that to achieve long-term stability the underlying sources of fragmentation need to be addressed through structural changes to the global financial architecture. This graduated approach allows policy-makers to address immediate challenges while working toward more fundamental solutions.

TABLE 3 | **Policy recommendations to improve global financial governance**

Increasing time required for implementation

Policy recommendations

Principles	Contend with existing fragmentation	Resist future fragmentation	Reform the system
1 Clearly define and uphold the rule of law 2 Respect financial and physical property ownership rights 3 Avoid unilaterally expropriating sovereign assets	Adopt existing best-practice definitions to define guardrails, including the rule of law		Enhance domestic capacity in governance, currencies and capital markets
4 Safeguard independence and bolster capabilities of international institutions 5 Regulate and manage critical financial market infrastructures, but avoid politicizing or severing the underlying rails	Strengthen adherence to international standards		Increase representation for EMDEs Depoliticize decision-making at IFIs
6 Ensure parallel financial market infrastructures are interoperable	Develop interoperability frameworks	Counteract distinct economic blocs with new or strengthened patterns of economic cooperation Establish greater policy cohesion to coordinate between emerging financial blocs	
7 Structure domestic and multilateral policies and financial regulations to support financial stability and cross-border flows	Anchor the guardrails and promote policy impact Establish a best-practice toolkit for economic statecraft Encourage mutual recognition of comparable standards and interoperability of regulatory regimes Standardize the regulation of cross-border capital, services, goods and data flows		Enhance EMDEs' access to capital Strengthen the global financial safety net Integrate AI, digital assets and fintech into the global regulatory environment
8 Shield the independence of fiscal and monetary policy	Use regular stress-testing to highlight negative externalities of financial fragmentation	Deepen intraregional integration (e.g. EU Capital Markets Union)	

Source: World Economic Forum and Oliver Wyman

4.1 Contend with existing financial fragmentation

Countries' conflicting geoeconomic interests and the resulting trust deficit among policy-makers is driving fragmentation of the global financial system. Since these diverging interests are likely to persist for the foreseeable future, this report echoes existing research in its call to mitigate the costs of fragmentation and counteract mistrust across the financial system.[72]

Anchor the guardrails and promote policy impact

Both the UN and the G20 have in the past helped establish voluntary codes of conduct and norms for addressing challenging governance issues, such as promoting "responsible state behaviour in cyberspace".[73] Similarly, the World Economic Forum has a track record of establishing multistakeholder governance and reporting frameworks such as the Stakeholder Capitalism Metrics. These institutions could

The foundational principles proposed in this report could guide future economic statecraft frameworks that support ongoing financial system integration, even amid geopolitical tensions.

leverage their collective reach and convening powers to facilitate a similar articulation of shared principles to protect the integrity of the global financial system. By drawing on this report's foundational Principles to Safeguard the Global Financial System from Fragmentation, informed and articulated by private-sector leaders from across global financial services, the UN and G20 could work with the World Economic Forum and its partners to build a framework that guides future economic statecraft in ways that facilitate ongoing financial system integration, even in the face of geopolitical tensions.

Adopt existing best-practice definitions to define guardrails, including the rule of law

Policy-makers should use synergies with existing agreements, such as the G20 High-Level Principles on Preventing and Combating Corruption in Emergencies, to kick-start the design of appropriate guardrails.[74] This set of G20 principles could encourage governments to uphold their domestic legal systems and enforce global financial regulations. Other indispensable elements of the financial system that must be protected include the independent operation of international institutions and standard-setting bodies.

Establish a best-practice toolkit for economic statecraft

To operationalize high-level principles or norms, policy-makers should work with the private sector to establish a best-practice toolkit for implementing economic statecraft measures. Given the FATF's global reach as a standard-setter to combat money laundering and terrorist financing, the institution could be tasked with developing and propagating rules for responsible economic statecraft in close cooperation with countries' financial intelligence units (FIUs). The Rules of Engagement for Responsible Economic Statecraft outlined in this report identify how governments can optimize their policy processes to craft more targeted and better-aligned economic statecraft measures that minimize unintended consequences. Two additional mechanisms include developing public–private consultation systems and establishing standard protocols for implementing and enforcing economic statecraft measures.

Business mitigation strategies: Engage additional experts
Bringing in specialists in geopolitical risk strengthens financial institutions' ability to anticipate and manage complex global challenges.[75]

Leverage established financial governance structures to reduce the growing costs of a fragmented financial system

The G20 can help ensure that major financial powers prioritize compliance with international standards by supporting the CPMI, FSB, BCBS and IOSCO and others. Upholding international standards improves harmonization across the financial system. Action items include:

- **Developing interoperability frameworks:** Policy-makers and regulators can offset the efficiency losses caused by the emergence of parallel financial market infrastructures by building on existing efforts, such as the G20 Roadmap for Enhancing Cross-Border Payments.[76] As new networks proliferate, stakeholders can mitigate the negative effects of fragmentation by ensuring that interoperability frameworks connect new systems with each other and existing infrastructures, alike.

- **Encouraging mutual recognition of comparable standards and interoperability of regulatory regimes:** To enable the private sector to enter or remain in certain jurisdictions that face higher compliance costs due to extraterritorial regulation, policy-makers should promote interoperability and, where possible, "encourage greater comparability of regulatory regimes through mutual recognition and equivalence rather than line-by-line comparability".[77] Such measures ease access and reduce compliance costs for the private sector.[78]

- **Standardizing the regulation of cross-border capital, services, goods and data flows and strengthening adherence to international standards** to shield supply chains, foreign exchange markets and other sectors from the disruptive impacts of fragmentation.

Use regular stress-testing to highlight the negative externalities of financial fragmentation

The existing stress-testing infrastructures of financial governance institutions, such as the IMF's Global Bank Stress Test and a similar exercise led by the FSB and BCBS, could provide a platform to better quantify the risks of geoeconomic-driven financial fragmentation on a recurring basis.[79] Such a mechanism would promote transparent data sharing and enable decision-makers to gauge the potential costs of economic statecraft measures. Establishing greater transparency regarding the likely risks of an escalation is the best tool to defuse geopolitical tensions.

4.2 Resist further system fragmentation

> Even if distinct financial blocs form, there are different potential institutional and private-sector channels that can build connective tissue between blocs to stop them from drifting farther apart.

To resist further financial fragmentation in a more multipolar system, it is essential for major powers, financial institutions and the private sector to preserve the cooperative nature of the current financial architecture.[80] One option would be for governments to restrict financial flows in certain sensitive areas only and promote unhampered activity in all other parts of the economy – the "small yard and high fence" model.[81] However, even in the case of distinct financial blocs forming, there are different potential institutional and private-sector channels that can build connective tissue between blocs to stop them from drifting farther apart.

Counteract distinct economic blocs with new or strengthened patterns of economic cooperation[82]

While this report stresses the benefits of financial integration and further regulatory harmonization, current global policy trends point to increasing fragmentation of the global financial system as policy-makers balance policy objectives with financial system efficiencies. This report's quantitative analysis suggests that rewiring certain financial flows, global production and trade routes between blocs through connector countries (e.g. Mexico or Viet Nam) that are not aligned with any bloc would create a less costly new status quo. Such a "low fragmentation" scenario is estimated to result in output losses of around 0.5% of global GDP, while a "very high fragmentation" scenario, with all countries forced to join a large economic bloc, albeit unlikely, could reduce global GDP output by more than 5%. To promote financial integration and minimize the burden on legitimate economic activity, policy-makers can protect firms' ability to conduct business across jurisdictions and the geopolitical spectrum.

Establish greater policy cohesion to coordinate between emerging financial blocs[83]

Digital cross-border payments create an opportunity for the financial sector to facilitate policy cohesion to make global payments more efficient, inclusive and transparent.[84] Following Russia's invasion of Ukraine, many advanced economies and EMDEs explored multi-country cross-border digital currency projects, such as Project mBridge or Project Agorá, but the ventures lack the support of appropriate standards and financial architecture. Policy-makers can leverage standard-setting bodies, including the BCBS, CPMI and IOSCO, to develop "interoperability standards" to safeguard the system's operation.[85] Stakeholders can build on ongoing efforts by the IMF, BIS and SWIFT, which are all developing models to enable digital cross-border payments, to design a new institutional framework.

To reduce regulatory friction in the financial system, decision-makers can develop a basic universal framework to flag potential issues before implementing policy proposals. This approach would streamline, depoliticize and increase the efficiency of current international regulatory processes.

Deepen intraregional integration

To guard against the risks and costs of global financial fragmentation, policy-makers should deepen economic and regulatory cooperation within their respective regions without discriminating against third countries. Harmonization of regulatory frameworks is one example of promoting competition, liquidity and reduced cost of capital. As outlined in the recent Draghi Report, the EU can further integrate financial markets to support investment and economic growth.[86]

Policy-makers should align monetary, fiscal and structural policies in regional blocs to address key pain points caused by policy-induced fragmentation, including regulatory decoupling and financial instability. Should financial fragmentation deepen, regional blocs can establish mutual support arrangements that may include regional safety nets, currency swaps and fiscal mechanisms, as well as precautionary credit lines from international financial institutions. These measures may be necessary to strengthen the resilience of individual economies and contribute to a more stable global financial system overall.

4.3 Reform the global financial system

Under the existing architecture, fragmentation imposes the greatest costs on EMDEs. Decision-makers can improve the global financial system by changing its existing mechanics to better accommodate the needs and interests of EMDEs. For example, exempting climate finance vehicles from restrictive statecraft measures could allow EMDEs to mobilize resources more effectively. Likewise, restructuring the governance bodies of international financial institutions could afford EMDEs greater input into the system's design. The following list highlights key areas for action.

Enhance domestic capacity in governance, currencies and capital markets

Strong partnerships among governments, national public financial institutions, the private sector and MDBs can create conducive investment environments, mitigate risks, improve liquidity and effectively deploy investments.[87] Closer collaboration with other EMDEs and advanced economies, IFIs and multinational corporations can help strengthen regional capital markets and domestic currencies through sound fiscal and monetary policies and robust financial regulations.

> Supporting EMDEs' development and sovereignty enables them to become global custodians of a stable global financial system that supports economic prosperity.

Supporting EMDEs' development and sovereignty enables them to become custodians of a stable global financial system that supports economic prosperity.[88] The G7 and major emerging economies, including China and India, can use positive economic statecraft to enhance the resilience and capacity of EMDEs' economies and capital markets, among other goals. Recognized as ambitious and also debated, China's Belt and Road Initiative provided African countries with over $20 billion in financing in 2023.[89] Meanwhile, the EU's Global Gateway programme aims to mobilize up to €150 billion in investments in Africa by 2027.[90] Starting in 2025, a consortium of Indian banks is providing a $300 million syndicated loan to finance infrastructure investments in Africa.[91] These initiatives demonstrate how states can leverage positive economic statecraft policies and encourage private sector-led engagement to advance their interests while fostering mutual economic benefits.

Increase representation for EMDEs

The current monetary architecture will likely struggle to retain its centrality without increasing EMDEs' influence in the decision-making processes of international financial institutions. Possible reforms include:

- Redistributing quotas and recalibrating voting shares
- Increasing the number of EMDE-representing board chairs
- Expanding G20 membership by focusing on African representation

Depoliticize decision-making at IFIs

Appointing top officials based on broad consensus and professional qualifications, rather than political affiliations, would be beneficial for fostering credibility and effectiveness within these institutions. Furthermore, shifting operational decision-making from the executive boards to professional management can help reduce political influence and enhance overall efficiency. By implementing these reforms, IFIs can better serve their purpose of promoting global financial stability and development.[92]

Enhance EMDEs' access to capital

Reforming MDBs could unlock an additional $500 billion in annual lending. Key changes include establishing more flexible lending criteria and increasing the availability of low-cost and concessional public financing. An overhaul of MDB capital adequacy frameworks would enable more low-cost loans, allow "loss and damage" facilities to support vulnerable countries and speed the disbursement of World Bank funds.[93]

Moreover, MDBs can increase flexibility in their support for EMDEs by developing market-based mechanisms to manage bondholder negotiations in sovereign debt restructurings and by decoupling MDB quotas and resource contributions from lending practices. Improving climate finance is another critical area for development, and IMF and World Bank deliberations could use climate vulnerability as a category of formal consideration. The G20 Common Framework for Debt Treatments could also facilitate EMDEs' greater access to capital by including debtor middle-income countries, setting timelines for resolutions and ensuring that all creditors participate in multilateral debt negotiations.[94]

Strengthen the global financial safety net

The GFSN requires urgent reforms to provide essential global liquidity and help EMDEs manage external financing vulnerabilities. Increasing fragmentation is already reshaping bilateral swap lines and regional financial arrangements, making enhanced coordination between emerging financial blocs even more essential.[95] The IMF already plays an established role in facilitating cross-border collaboration and is positioned to lead efforts to strengthen the monitoring of financial flows, improve crisis-prevention mechanisms and coordinate responses to economic disruptions.[96]

Integrate AI, digital assets and fintech into the global regulatory environment

The safe and efficient integration of AI, digital assets (especially digital currencies) and fintech applications into the global financial system can promote financial inclusion and greater EMDE economic participation. However, the emergence of these technologies requires the development of voluntary international standards and policies, as well as regulatory frameworks that facilitate interoperability, efficiency and a level playing field with traditional financial institutions. Diverse stakeholders from around the world must actively participate in standard-setting initiatives, recognizing that these standards should be adaptable to technological advances and evolving economic priorities, while "embedding" the rule of law.[97] Ultimately, the goal should be to create a more equitable and accessible global financial landscape.

4.4 Concluding thoughts

A central objective of the Navigating Global Financial System Fragmentation initiative is to ensure that financial stability and capital markets benefit the approximately 7 billion people on the planet. It is highly probable that the world will be more multipolar in the near future. Against this backdrop, the guardrails outlined in this report are designed to limit excess fragmentation and protect the integrity of the global financial system. These frameworks do so without infringing on national sovereignty, while still safeguarding the ability of the financial sector to fulfil its fundamental role of intermediating global savings and channelling them to promote investment and economic growth for individuals, businesses and governments. By directing the benefits of financial flows towards achieving development goals, particularly the Sustainable Development Goals (SDGs), the global financial system and its participants can help create a more equitable and sustainable future.

Appendix: Key terminology

Economic statecraft	Economic statecraft refers to the use of economic tools and policies by a state to achieve its foreign policy objectives and enhance domestic resiliency. Coercive statecraft includes sanctions and measures to pressure countries that violate international norms or threaten a government's geopolitical or economic interests. Positive statecraft includes inducements, such as trade agreements aimed at improving relationships and fostering cooperation. By leveraging these economic instruments, often bundled into industrial policy, states aim to influence other countries' behaviour while also strengthening their domestic economies.
Financial market infrastructures (FMIs)	Financial market infrastructures (FMIs) are essential components of the global financial system and provide the foundational framework for the efficient operation of financial markets. They include payment systems, central securities depositories, securities settlement systems, central counterparties and trade repositories, all of which facilitate the processing, settlement and safeguarding of financial transactions.[98]
Geoeconomic fragmentation	Geoeconomic fragmentation refers to the division of the global economy into distinct, often competing economic blocs or spheres of influence, driven by geopolitical tensions and national interests. Investment restrictions, financial sanctions and prioritization of domestic industries over international cooperation are hallmarks of such fragmentation. Countries' increasing focus on their economic interests can jeopardize the seamless flow of goods, services and capital, which leads to inefficiencies and a more fragmented global economic landscape.
Geopolitical fragmentation	Geopolitical fragmentation describes the breakdown of international relations and alliances, resulting in a more divided global political landscape. Rising nationalism, the emergence of rival power blocs and the erosion of multilateral institutions characterize such trends, which can exacerbate tensions, conflicts and a lack of cooperation on global issues. As nations prioritize their sovereignty and strategic interests, the ability to address shared challenges collectively diminishes.
Global financial safety net	The global financial safety net (GFSN) is a multilayered framework that provides financial stability and support to countries facing economic distress. It comprises four key components: central banks' foreign exchange (FX) reserves, bilateral swap lines (BSLs), regional financing arrangements (RFAs) and the International Monetary Fund (IMF). The GFSN ensures that countries have access to necessary liquidity and support, particularly in times of geoeconomic fragmentation, which can affect both the demand and supply of these resources.
Global financial system	The global financial system refers to the interconnected network of financial institutions, markets and instruments that facilitate the flow of capital within and across borders. Its actors include central banks, commercial banks, investment firms and regulatory bodies, which work together to allocate resources, manage risks and provide liquidity. It is complex and diverse and includes a wide array of financial products, services and agreements, both formal and informal, which collectively facilitate the movement of financial capital for investment and trade. Its effective functioning promotes economic growth, stability and integration among nations by moving funds necessary for development and commerce. The global system depends on the substrate of domestic financial markets, local banks, stock exchanges, bond markets and other financial institutions that mobilize domestic savings, provide credit and facilitate investments within individual countries.
Global financial system fragmentation	Global financial system fragmentation refers to the increasing disintegration of the interconnected global financial landscape into distinct blocs. Fragmentation arises from geopolitical tensions, regulatory divergence and the emergence of regional financial systems that operate independently of one another. As countries prioritize national interests and security concerns, the seamless flow of capital, investment and financial services is disrupted, leading to a more fragmented environment.
International financial institutions (IFIs)	International financial institutions (IFIs) are multilateral organizations established by countries to provide financial support, technical assistance and policy advice to foster economic development and stability. These institutions facilitate access to capital, promote sustainable development and address financial crises. Examples include the International Monetary Fund (IMF), the World Bank Group and regional development banks such as the Asian Development Bank (ADB) and the African Development Bank (AfDB). IFIs work collaboratively with member countries to enhance economic resilience, reduce poverty and promote inclusive growth through targeted financial interventions and capacity-building initiatives.
Rule of law	The rule of law is a political ideal that all individuals and institutions are held equally accountable to evenly enforced laws. The rule of law frequently means different things in different jurisdictions, but universally, it protects fundamental rights, including the security of persons and property. It maintains order, promotes justice and fosters trust in legal and governmental systems.

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