HSBC Global Research

17 June 2021

Banking on growth

The pandemic accelerates EM financial inclusion

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Economics - Global

- As more people in emerging markets get access to digital payment methods the transition from cash is accelerating
- Technology adoption could bolster financial inclusion, spur the recovery, and reduce poverty
- We look at which EM economies are set to make progress

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The pandemic has forced people away from cash across the world. With shops closed, more shopping is online, and where they are open, businesses have favoured digital payments to minimise contact. Pre-pandemic, emerging markets were using far more cash than in developed markets, largely because they have a number of barriers to getting people banked and even larger hurdles to digitising accounts. But the shift away from cash has accelerated across EM in the last year.

As a result of the pandemic, EM economies have seen growth rates slashed, and many are a long way from where pre-pandemic forecasts would have expected activity levels to be. This means new drivers of higher potential growth are more key than ever. Shifting from cash and improving bank account access could help spur the economic recovery by boosting online commerce, access to credit, and the efficiency of remittances which can make up a significant portion of GDP in emerging markets.

In this report, we look more closely at the use of cash in economies across the world. The transition from cash to digital payments in EM has been hampered by low wages, a lack of trust, lack of documents, and banks being far away. Moreover, nearly one third of the unbanked population do not have a mobile phone. Emerging markets also lag in access to the internet and financial literacy. As we detail, the pandemic has brought forward much of the infrastructure and programmes required for fintech to thrive as governments have had to expand broadband to remote areas, enhance digital identification, and shift antiquated government systems online. The acceleration in central bank digital currency developments could speed things up, too.

The speed with which emerging market economies reach developed market levels of financial inclusion will be varied, but the pandemic may expedite this. Getting more people banked is crucial to the process. And while there is no silver bullet it seems that moving government payments online during the pandemic has had a transformative effect, particularly in much of Latin America. According to our analysis, economies where there could be a clearer trend to reaching DM levels of financial inclusion include Brazil (which has already seen a 73% fall in the unbanked population due to COVID-19 social benefits programmes), mainland China, Chile, India, Malaysia, and Thailand, while Indonesia, Egypt, Mexico, the Philippines, and Vietnam are economies to watch and could all achieve massive leaps forward from their current (very low) levels.

This is an abridged version of a report by the same title published on 17-Jun-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information.

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Contents

Financial inclusion and EM

- Financial inclusion has long been important for equality purposes …
- … and could now be vital for future growth prospects too
- The pandemic accelerated the shift away from cash and may boost financial inclusion: we look at which countries could benefit most

Why is financial inclusion so key now?

As a result of the pandemic, EM economies have seen growth rates slashed, and many are a long way from where pre-pandemic forecasts would have expected activity levels to be. For many, longer-term potential growth could have been pulled down as a result of the scarring. HSBC Economics predicts Indian potential growth could fall by 1ppt to 5%, the lowest rate since the turn of the millennium and in the ASEAN region the Philippines, Thailand, and Indonesia are likely to take the largest hits to potential growth. All this means new drivers of higher potential growth are more key than ever.

Having more people banked could help to unlock new drivers in the coming years. In fact, economies that switch away from cash and towards digital payments could see a boost to annual GDP by as much as 1% in mature economies and more than 3% in emerging markets according to the Boston Consulting Group. The analysis cites South Korea and Sweden as examples, which have seen a shrinking informal economy, booming online commerce and a reduction in fraud[1].

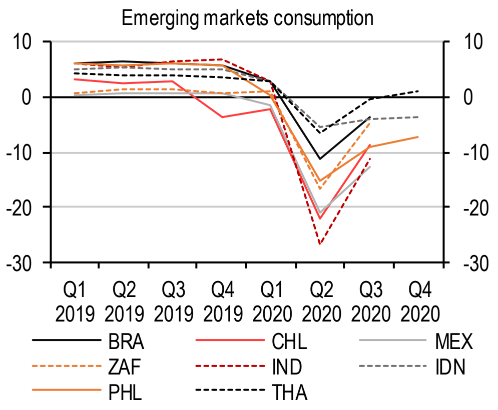
Online retail

Financial inclusion is a vital piece in the puzzle for expanding the e-commerce sector in emerging markets. Moreover, it will allow firms to expand into new areas at lower cost and to expand their customer bases. MasterCard estimates that there could be a permanent stickiness factor of 20-30% in e-commerce retail spending – in South Africa 68% of consumers are shopping more online and 76% of them say they will continue this trend after the pandemic. It is no coincidence that 76% of South African consumers also said they had learnt to bank online during the pandemic. In order for shopping to move online, first people must bank online[2].

The growth of online retail could play a key role in helping to grow businesses, and in creating new jobs – important both as economies recover and as they need to generate more jobs further down the line. For more on the digital economy please.

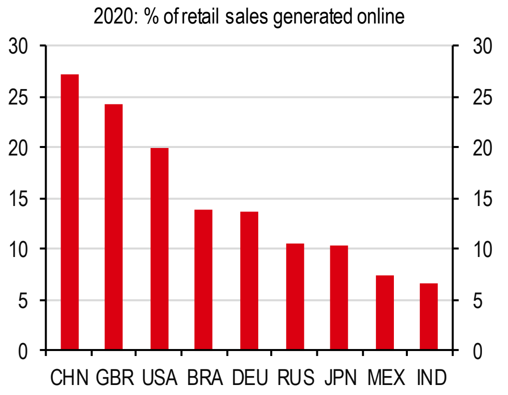
[1] How Cashless Payments Help Economies Grow, BCG, 28 May 2019
[2] MasterCard Global Outlook 2021 Highlights Permanent Shift to Digital and Opportunity to Boost Financial Inclusion in the Middle East and Africa, MasterCard, 13 January 2021

1. Fintech could help to boost growth …



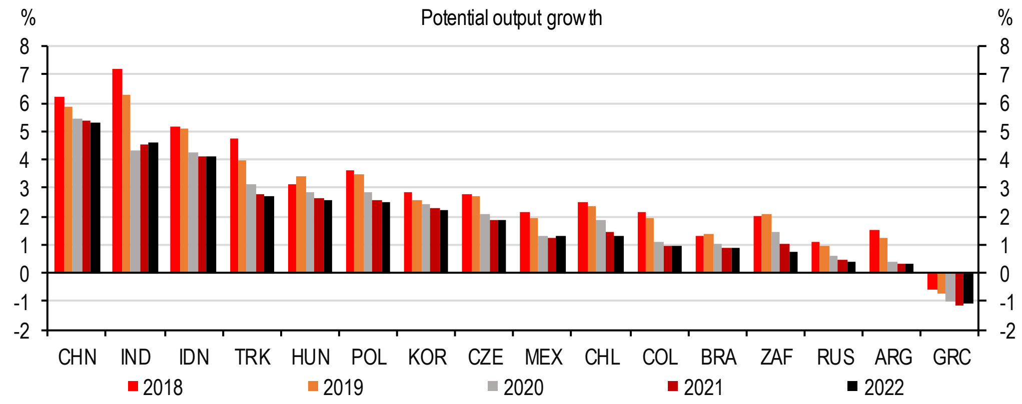
Source: Refinitiv Datastream

2. … and online sales could be the key to unlocking pent-up demand



Source: Euromonitor International

3. Emerging markets are seeing lower potential output rates post COVID-19



Source: OECD, Economic Outlook 108

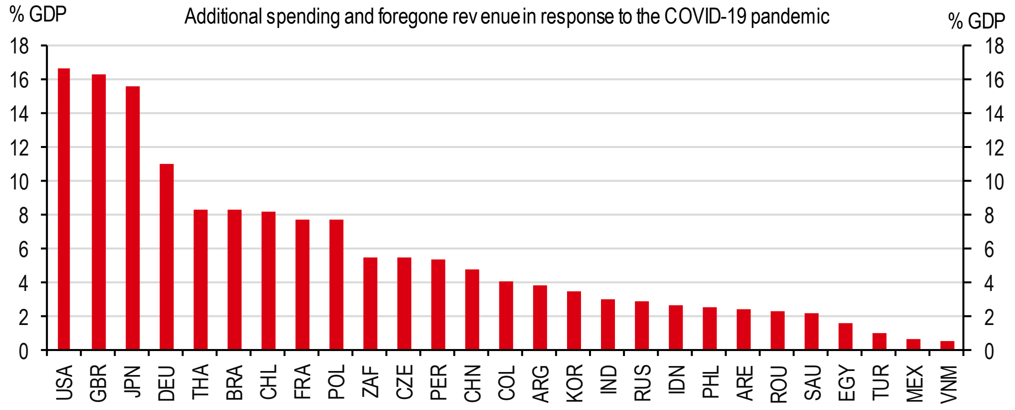
Easier direct payments

In 2017, the World Bank estimated that digitising all government payments could shift 100m people from unbanked to banked and that of the 230m unbanked adults in the private sector who are paid exclusively in cash, 78% of them have a mobile phone. A MasterCard study of Argentina, Brazil, and Colombia found that, thanks to social benefit programmes during COVID-19, their unbanked populations fell by 18%, 73%, and 8%, respectively – totalling 40m people becoming 'banked'. Markets like Chile, Peru, and Uruguay were not included in the study, but if their markets had similar results the unbanked population in all of Latin America may have been reduced by 25% solely from COVID-19 social benefit programmes [3].

Similarly, Pakistan leveraged previous investments in digital infrastructure for social protection payments to deliver COVID-19 payments to 16.9m households (109m people, 50% of the population) in just 10 days[4]. In effect, governments have created demand for cash transfer programmes and thus for online current accounts. Even when the emergency payments stop these individuals will still be online and, if they are given more education about how to benefit from online products, financial inclusion could benefit further.

[3] The acceleration of financial inclusion during the COVID-19 pandemic: Bringing hidden opportunities to light, MasterCard, October 2020
[4] Ehsaas Emergency Cash programme covering around 109 million people, Associated Press of Pakistan, 20 August 2020

4. Governments have embarked on huge fiscal stimulus programmes and if this cash is passed onto consumers digitally, it could force an increase in online banking

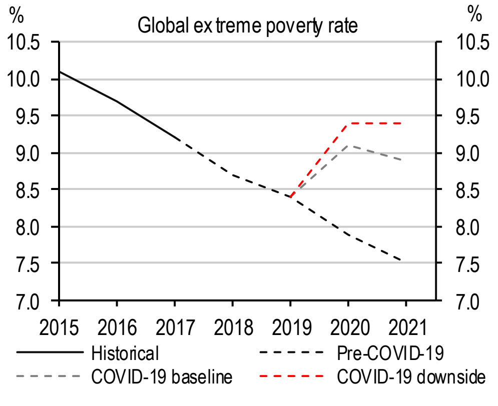


Source: IMF Fiscal Monitor Database

Supporting those most in need

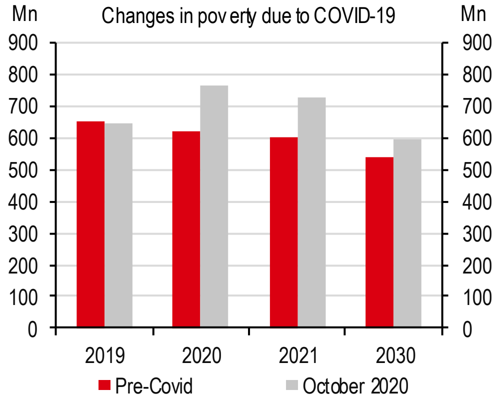
Global extreme poverty (living on less than USD1.90 a day) is expected to have increased in 2020 for the first time in more than twenty years. Extreme poverty was forecast to fall to 7.9% of the world's population in 2020; instead it is expected to be 9.1-9.4%[5]. This could mean up to 100m people worldwide could have been pushed into extreme poverty, the equivalent of eradicating all the gains made in the last 3 years[6]. Bolstering financial inclusion is an opportunity to generate growth because it allows workers to enter the formal finance sector, enables them to borrow more cheaply, save, and make and receive payments securely.

5. COVID-19 has set global poverty progress back years …



Source: The World Bank. Note: Extreme poverty is measured as the number of people living on less than USD1.90 per day. 2017 is the last year with official global poverty estimates

6. … with over 100m more people in extreme poverty in 2020 and 2021 as a result



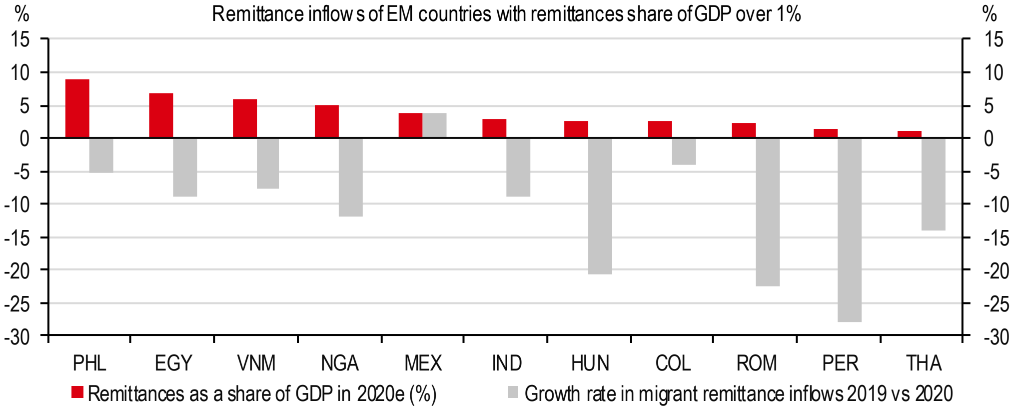
Source: Brookings Institution. Note. Extreme income poverty is defined as compromising families living in households spending less than USD1.90 per person per day in 2011 PPP terms

[5] COVID-19 to Add as Many as 150 Million Extreme Poor by 2021, The World Bank, 7 October 2020
[6] The Global Economic Reset – Promoting a More Inclusive Recovery, IMF, 11 June 2020

Remittances

In 2021, remittance flows globally are expected to shrink 14% compared to the pre-COVID-19 levels in 2019, and flows to low and middle-income countries are projected to fall by 7% in 2020 followed by a further decline of 7.5% in 2021[7]. Whilst a lot of this is down to weak economic growth and employment in host countries, and the depreciation of currencies of remittance-source countries against the US dollar, lowering the costs and increasing the speed of international payments using digital payments could help mitigate rising poverty. Many EM countries are quite vulnerable to a reduction in remittances. In the Philippines remittances make up 8.8% of GDP and it is estimated in 2020 that they fell 5.2%, while Vietnam saw a 7.7% reduction in remittance inflows, which account for 5.8% of GDP.

7. Remittances are an important GDP component for EM



Source: World Bank

The importance of remittances as a source of external financing for developing countries cannot be underestimated. In 2019 remittance inflows to developing counties were larger than foreign direct investment and overseas development assistance. According to the World Bank's Remittance Prices Worldwide Database the global average cost of sending USD200 was 6.8% in Q3 2020, more than double the UN target of 3% by 2030.

Can digitisation be afforded?

The cost of broadening financial inclusion to all areas of society will be expensive and some governments may be hesitant to make such large investments at a time when debt-GDP ratios are at long-term highs following months of fiscal stimulus. Nonetheless, investments in broadband and internet access will bear fruit in the long term. The World Bank estimates that if internet access rises to 75% from 35% today in developing nations this could add up to USD2trn to their collective GDP and create more than 140m jobs worldwide. One study even suggests that there could be a 2-3% GDP growth difference in the long run between financially inclusive countries and their less inclusive peers[8].

This is an abridged version of a report by the same title published on 17-Jun-21. Please contact your HSBC representative or email AskResearch@hsbc.com for more information. The full report includes sections on: the countries to watch; a look at whether EM is going cashless, including the benefits of being digitally banked; and which countries are ready for change.

[7] COVID-19: Remittance Flow to Shrink 14% by 2021, World Bank, 29 October 2020
[8] The Global Economic Reset – Promoting a More Inclusive Recovery, IMF, 11 June 2020

Disclosure appendix

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