



The Covid-19 pandemic's near-term and lasting impacts on retail-payment systems: the good, the bad, and the ugly

April 29, 2020

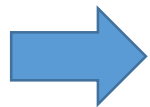
* Views expressed are strictly the author's.



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The economy is nosediving into a depression because of Covid-19-induced government business closures, roiling the payments industry.

- Eight of ten counties representing 96% of US national production are locked down. –a)
- “Dr. Doom” economist Nouriel Roubini predicts a deep depression. –b)
- JPMorgan forecasts 2nd quarter GDP will fall 40%. –c)
- Former Trump economist Kevin Hassett warned the coronavirus could cause another Great Depression. –d)
- Former Fed Chair Janet Yellen said the numbers look like a depression though in a different form from the Great Depression. –e)



Payments volume and mix have been drastically altered.

(a-Josh Mitchell, “State Shutdowns Have Taken at Least a Quarter of U.S.. Economy Offline,” WSJ, April 5, 2020

(b- Nouriel Roubini, “A Greater Depression?” Project Syndicate, March 24, 2020

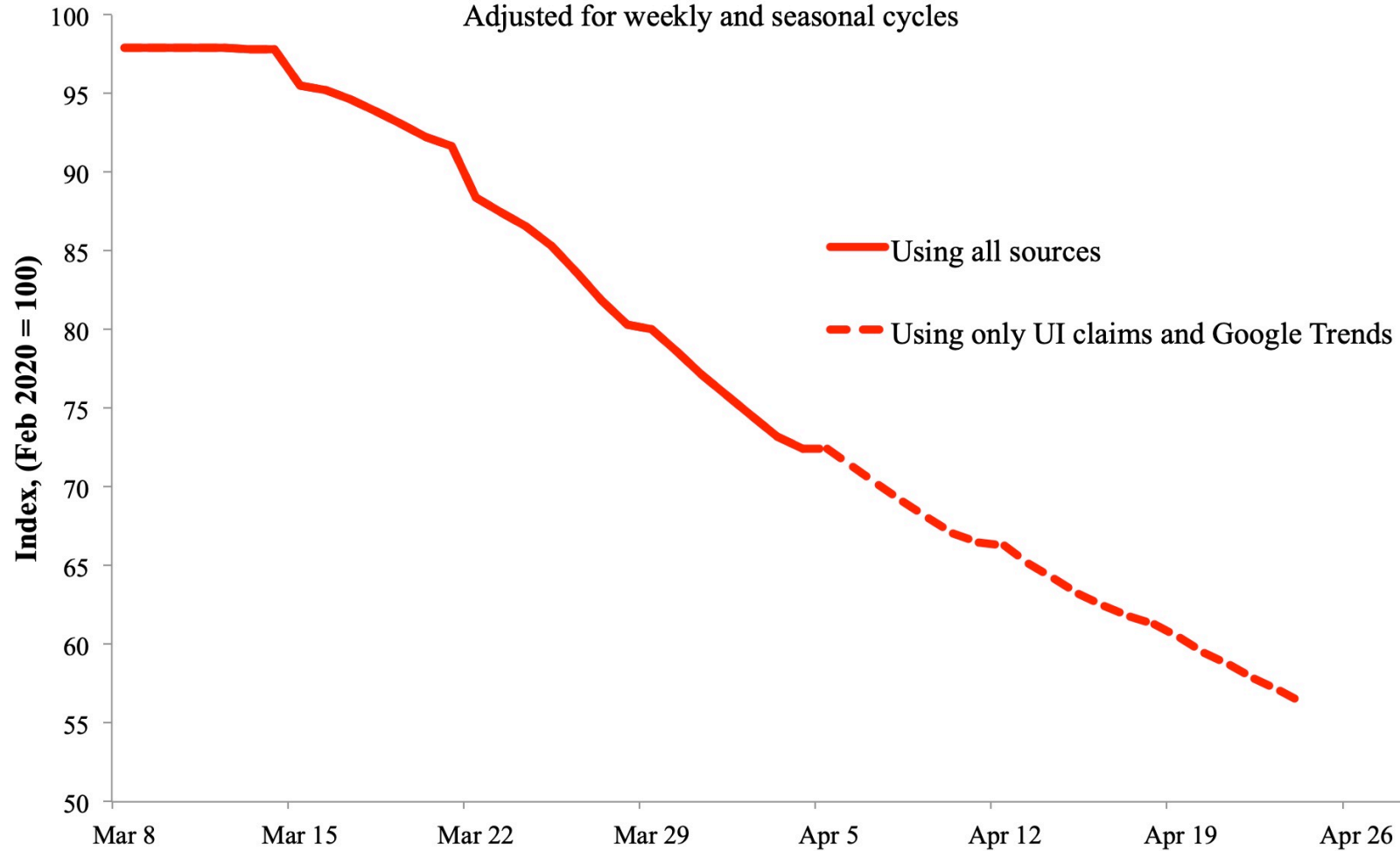
(c- Sergei Klebnikov, “JPMorgan Forecasts 20% Unemployment And 40% Hit To Second-Quarter GDP,” Forbes, April 10, 2020

(d- Matt Egan, “Coronavirus could spark another Great Depression,” CNN Business, March 19, 2020

(e-Jeff Cox, “Janet Yellen says second-quarter GDP could decline by 30% and unemployment is already at 12%-13%,” CNBC, April 6, 2020

Daily Estimates of GDP

Adjusted for weekly and seasonal cycles

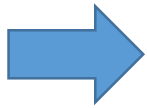


Sources: BLS Employment Situation, DOL Initial Claims reports, Bick and Blandin (2020), [Google Trends](#), calculations by Casey B. Mulligan

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Cross-border payments

- Borders worldwide are closed.
- International air traffic has come to a grinding halt.



Close to 100% of highly-profitable card-present cross-border payments have evaporated.

Issuers
Networks
Acquirers

- Covid-19 has, however, had one salutary effect, curbing merchants fleecing unsuspecting cardholders with Dynamic Currency Conversion.

Domestic payments in many but not all sectors have plummeted

- March seasonally-adjusted US retail sales down 8.7% yoy. –a)
- The number of people flying in the U.S. on Tuesday April 7th was down 95% yoy. –b)
- The number of passengers screened nationwide by TSA on April 12th was down 96% yoy. –c)
- Revenue per available U.S. hotel room declined ~ 84% yoy for the week ended April 11th. –d)
- For like-for-like-merchants ACI Worldwide reported April 1-8 global online ticketing and travel transactions down 98% and 92% yoy, respectively.

- Shift4 Payments' hospitality and restaurant transactions from April 14-20 against the week of February 2nd collapsed.



State	% change
California	-94%
Nevada	-97%
New York	-91%
Texas	-90%
Florida	-90%
Illinois	-94%
Georgia	-86%

(a- "Advance Monthly Sales for Retail and Food Services March, 2020," U.S. Census Bureau, April 15, 2020

(b- Justin Bachman and Mary Schlangenstein, "Airlines to cut summer flights up to 90% with rebound far off," Stars & Stripes, April 7, 2020

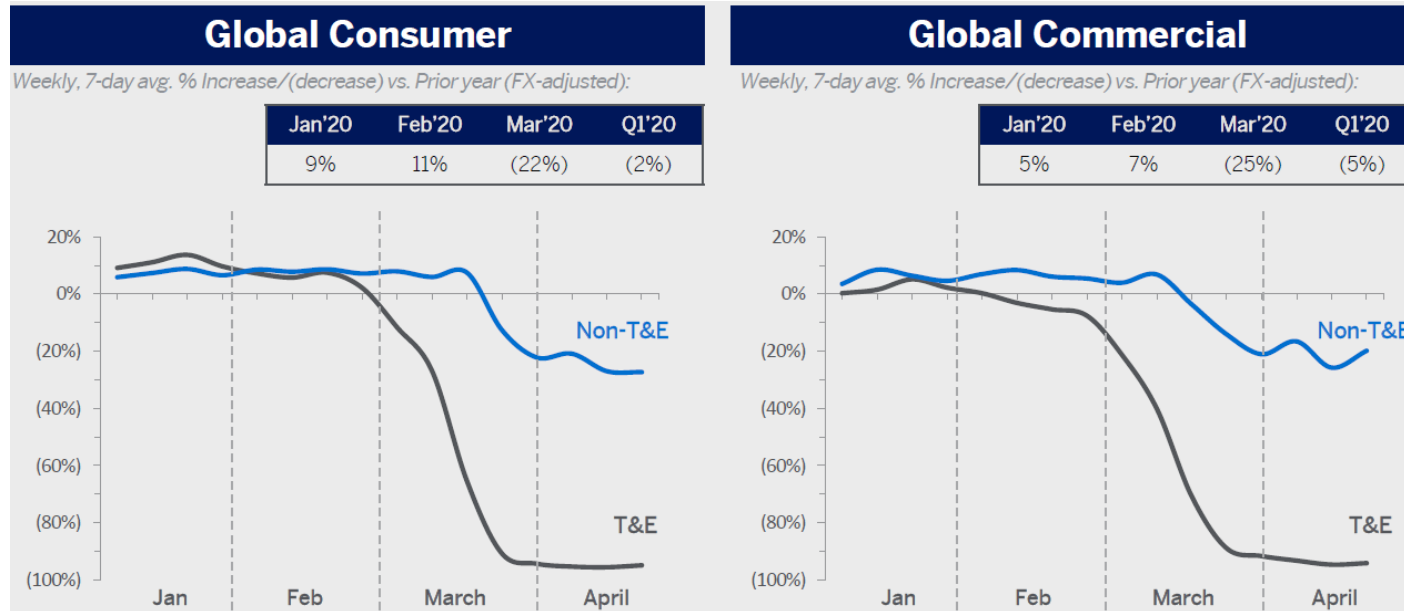
(c- Scott McCartney, "The Numbers on Travel's Unravelling," WSJ, April 16, 2020

(d- Mike Cherney, "Hotels Aim for Work-at-Home Crowd," WSJ, April 22, 2020

Domestic payments in many but not all sectors have plummeted

- Discover April payment volume the 19th yoy was down 60% for gas, 60% for restaurants, 99% for travel, and 29% overall. -a)

American Express payments trends



-b)

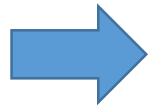
- If lockdowns are prolonged, credit-card issuer loss rates will eclipse those in the financial crisis.

(a- Discover

(b- American Express

Shutdowns

- Millions of SMEs are closed. Many won't recover.
- Storied department stores like Dillard's, Kohl's, Belk, Macy's, Saks, Neiman Marcus, JC Penny's, Sears, and Lord & Taylor are closed. Covid-19 will cull the already struggling herd. JC Penny's, Neiman Marcus and Lord & Taylor bankruptcies seem imminent. ^{-a)}



Closed businesses means no payments, no transaction fees for acquirers, networks, issuer processors, and issuers.

However, select sectors are booming in the crisis.

- ACI Worldwide reported like-for-like merchants' online gaming and retail payments April 1-8 up 172% and 58% yoy, respectively.
- March gun sales were up 85% yoy. ^{-a)}
- Ammunition retailer Ammo.com reported sales up a whopping 792% for the period February 23 through March 31st compared with January 1 through February 22, 2020. ^{-b)}
- For the week ending April 11th yoy baking yeast sales were up 410%, oat milk up 409%, aerosol disinfectants up 155%, powdered milk up 155%, and hand sanitizer up 129%. ^{-c)}
- E-commerce, with exceptions like gym subscriptions, is thriving. Emarsys reported in the 14 days prior to April 4th retail e-commerce in the US and Canada was up 43% yoy.

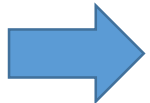
(a- Stephen Dinan, "Gun sales up 85% in March amid coronavirus fears," Washington Times, April 1, 2020

(b- Michael Moeser, "Coronavirus pandemic drives up gun payments," PaymentsSource

(c- Saabira Chaudhuri and Sharon Terlep, "Virus Outbreak Alters American Shopping Lists," WSJ, April 24, 2020

Increased retail concentration

- The strong are becoming stronger. Walmart's March sales were up 20% yoy. –a) It's hiring 150,000 temporary workers. –b)
- Amazon's hiring 100,000 workers. –c)
- Costco March sales initially surged midmonth but then ebbed because of social-distancing measures and closing departments such as optical –d)



Retail behemoths gaining share is negative for the payments industry, as they enjoy razor-thin net merchant acquirer fees, lower interchange fees, and debit-network "rebates."

(a- Rich Duprey, "Coronavirus-Inspired Panic Shopping Spikes Walmart Sales 20% in March," The Motley Fool, April 6, 2020

(b- Sarah Nassauer, "Walmart to Pay \$550 Million in Staff Bonuses, Hire 150,000 Temporary Workers," WSJ, March 20, 2020

(c- Dana Mattioli, "Amazon to Hire 100,000 Warehouse and Delivery Workers Amid Coronavirus shutdowns," WSJ, March 17, 2020

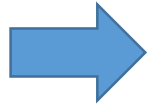
(d- Tonya Garcia, "Costco's March sales slowdown due to social distancing likely hit other retailers too, analysts say," MarketWatch, April 10, 2020

Washington

- President Obama's Chief of Staff Rahm Emanuel famously counseled "never let a serious crisis go to waste." The National Restaurant Association has taken heed. It asked President Trump, Speaker Pelosi and Majority Leader McConnell to reduce credit-card interchange fees. ^{-a)} Attempts to reduce interchange haven't moved as standalone legislation. Senator Durbin's successfully attached debit-interchange price controls to the must-pass Dodd-Frank Act. Restaurant lobbyists hoped to piggyback credit-card-interchange price caps on the Coronavirus Aid, Relief, and Economic Security Act. But restaurants are in dire straits because of being closed by government and fear of a virus, not interchange fees.

Cash

- The payments industry has battled cash since Diners Club's 1950 inception. Roughly 15.1% and 24.6% of 2018 US consumer-payment volume and transactions respectively were in cash, excluding mortgage payments. –a) In most countries cash is still the leading retail-payment system. The coronavirus has made merchants and consumers leery of transacting in potentially contaminated cash.
- NYC lawmakers may rue banning merchants banning cash. –b)



Acceleration of worldwide migration of cash to electronic payments.

- Short-term demand for cash, however, in some markets has surged, not for transacting but as a hedge.
- In Russia, about 1 trillion rubles (\$13.6 billion) has been issued from ATMs and bank branches since the beginning of March, more than during 2019. –c) Cash withdrawals spiked after Putin extended self-isolation measures at least until May and imposed a tax on bank deposits over 1 million rubles. –d)
- In the EU euro banknotes in circulation rose by €41.2 billion to €1.33 trillion, the largest increase since the 2008 financial crisis. –e)

(a- p. 10, Nilson Report # 1166, December, 2019

(b-Ed Shanahan and Jeffery Mays, "New York City Stores Must Accept Cash, Council Says," New York Times, January 24, 2020

(c- Alex Rolfe, "As global contactless transactions surge Russians turn to cash," Payments Cards & Mobile, April 21, 2020

(d- Ibid

(e- Ibid

Digital currencies

- Fear of the coronavirus will spur greater interest in digital currencies.
- Facebook pivoted from its plans announced last year, which provoked a din of hostility from regulators and politicians worldwide. The rethink –a) will keep Libra’s transaction ledger permissioned and back its stablecoins with each jurisdiction’s national currency, rendering them akin to electronic banknotes. That won’t threaten government monopolies creating money.
- Signature Bank and Chase have digital dollars supporting B2B payments. Wells Fargo Digital Cash will launch this year. They could be repurposed for retail payments.
- The Banque de France requested applications for digital-euro B2B-focused pilots.
- The PBC is rolling out a digital-currency pilot in 4 Chinese cities: Shenzhen, Suzhou, Chengdu and Xiong’an, a satellite city of Beijing.-b)

(a- https://libra.org/en-US/wp-content/uploads/sites/23/2020/04/Libra_WhitePaperV2_April2020.pdf)

(b- Jonathan Cheng, “China Rolls Out Pilot Test of Digital Currency,” WSJ, April 20, 2020)

Contactless

- For a quarter of a century the US payments industry has half-heartedly tried to spur contactless payments. In 1996 Mastercard in Manhattan and Visa at the Atlantic Olympics ran pilots. It wasn't compelling for either consumers or merchants. Swiping cards was habit and nearly frictionless.
- Google Wallet, Apple Pay and Samsung Pay launched in 2011, 2014, and 2015, respectively. Mobile-wallet evangelists enthused they would usher in an era of contactless payments at NFC-enabled merchants. Joe Cardholder and Jose Merchant didn't bite.
- Covid-19 is more persuasive. Cardholders and merchants don't want to touch. Issuers are rushing to put contactless cards in consumers' leather wallets.

The end of signature authentication

- Pos signatures will disappear. March 23, 2020 Mastercard reminded acquirers payments at the physical pos by card or mobile phone don't require signatures.

E-commerce

- E-commerce will resume healthy growth and continue to gain payments share.

Payments nationalism

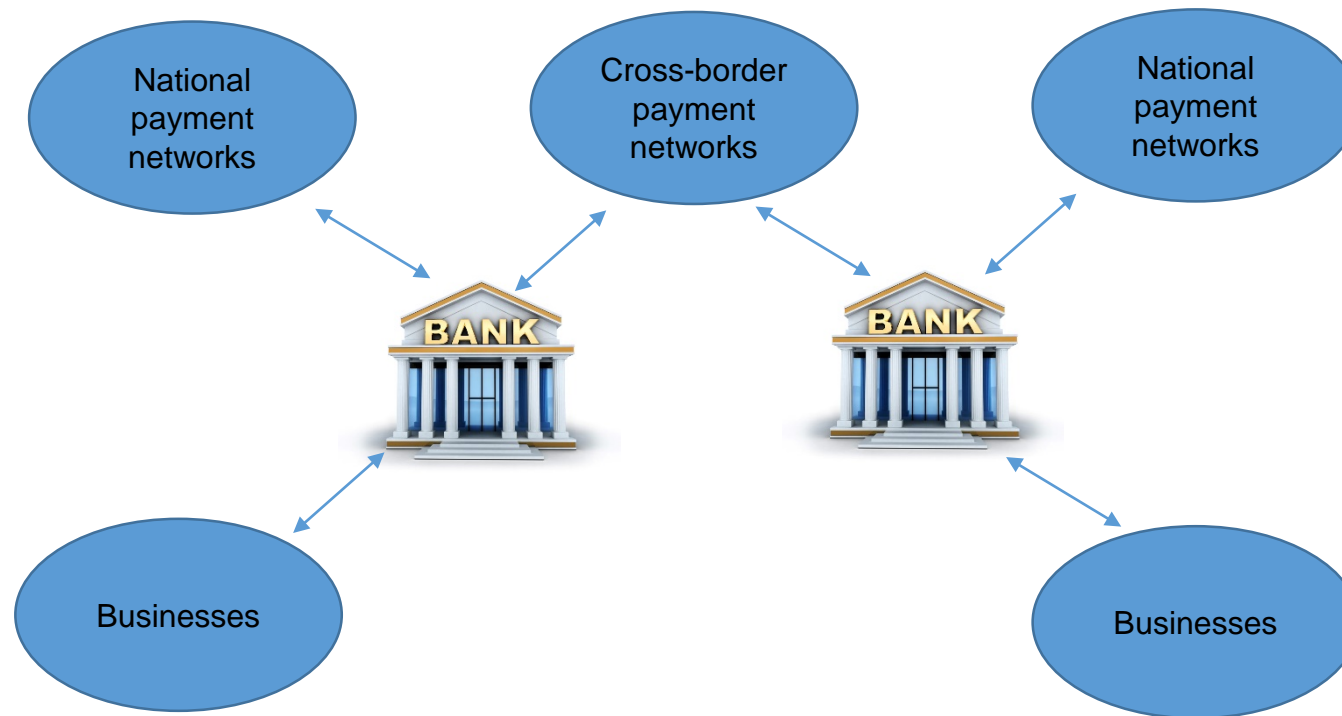
- Borders and control of critical supply chains for ventilators, masks and drugs, are at the fore. Many nations and the supranational EU view payments as critical infrastructure. The Wuhan virus is stoking protectionist sentiment.
- ECB board member Benoît Cœuré lamented that the leading pan-European card schemes aren't European, declared that "dependence on non-European global players creates a risk that the European payments market will not be fit to support our Single Market and single currency, making it more susceptible to external disruption such as cyber threats, and that service providers with global market power will no necessarily act in the best interest of European stakeholders." He declared "Strategic autonomy in payments is part and parcel of the European (EU) agenda." –a)
- The EU wants a pan-EU payment system to take resented American Mastercard and Visa down a notch. Playing to Brussels' sentiment, the EACB, EBF and ESBG decry –b) intra-EU cross-border payments only being possible because of "a few global, non-European market players," i.e. Mastercard and Visa, and hail policymakers' call to create European pan-European payment solutions."
- Mastercard and Visa, in particular, but also American Express, Discover and PayPal will face increased protectionist headwinds worldwide.

(a- Benoît Cœuré, "Towards the retail payments of tomorrow: a European strategy," November 26, 2019

(b- <https://www.wsbi-esbg.org/SiteCollectionDocuments/ECSAs-Policy-Paper-Payments.pdf>

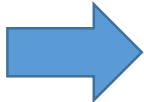
Adjacent opportunity space: B2B

- Global B2B payments market ~ \$125 trillion. –a)
- Mastercard and Visa are insinuating their networks at multiple nodes in the worldwide B2B payments ecosystem.



Leveraging existing delivery systems and building and acquiring new B2B delivery systems

- Corporate purchasing cards
- Virtual cards
- Noncard-based rails
 - Visa acquired Earthport and launched B2B Connect
 - Mastercard acquired Transfast, Vocalink and Nets account-to-account assets(pending)
- Software around B2B payments
 - Visa acquired Fraedom
 - Mastercard invested in AvidExchange



The two genuinely global retail-payment networks are well-positioned to capture significant B2B payment share. Owning open national and cross-border networks should be the sweet spot. Around the edge however, cultivating a competitive processing and software ecosystem rather than owning and delivering proprietary solutions, is consistent with their business model.

Closing thoughts

- The Covid-19 depression will be as deep as the Great Depression and what James Grant called the Forgotten Depression of 1920-21. Whether it's a sharp V-shaped, a W-shaped recovery, or a prolonged malaise, depends on beating the virus, and government letting market forces do their magic as they did in 1920-21, but not in the Great Depression.
- Washington raining trillions of dollars on the economy may mitigate the immediate pain, albeit at a dangerous long-term cost. However, the economy and payments industry can't start to fully recover until there's a vaccine(s) and/or effective treatments. As of April 6th there were more than 200 clinical trials of coronavirus treatment or vaccines in process or recruiting test patients. –a)

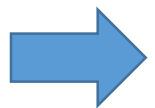


(a- "Treatments for Covid-19: Drugs being tested against the coronavirus," LiveScience, April 7, 2020. The Milken Institute lists 175 treatments and 95 vaccines in some stage of development.

https://docs.google.com/spreadsheets/d/16DbPhF9OD0MHtCR12of6yUcfiRzP_-XGkynEbnipds/edit#gid=2075421071

Closing thoughts

- Covid-19 will be vanquished.
- Commerce at the physical pos will come back. Virtual bars, restaurants, and barbershops don't cut it. Nobel-prize winning economist Vernon Smith observes "once the pandemic passes and vaccines and treatments appear, people will be ready again to spend on services, travel and hotels." –a)
- Americans, slowly, will return to bars and restaurants, fly to Europe for business and holidays, and again take cruises.
- Cross-border traffic will crawl back.



The payments industry will adapt, weather and slowly emerge from the coronavirus storm, likely in 2021. A battered and changed payments industry will return to growth.

Q&A