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A mixed 2015 for the global payments industry

Financial Services September 2016

While strong fundamentals continued, slower growth left payment revenues essentially flat in many regions last year.

The global payments industry faced strong headwinds in 2015, as the promise shown in 2014 did not continue to play out on the top line. Following 2014's exceptional 9 percent revenue growth, global revenues rose by just 3 percent in 2015 (to \$1.8 trillion). Important regional differences underpin these results, as EMEA (Europe, the Middle East, and Africa) payments revenues were essentially flat compared to 2014 and APAC (Asia Pacific) revenue declined for the first time since McKinsey began tracking regional segments, while North America and especially Latin America enjoyed higher growth than in previous years (Exhibit 1).

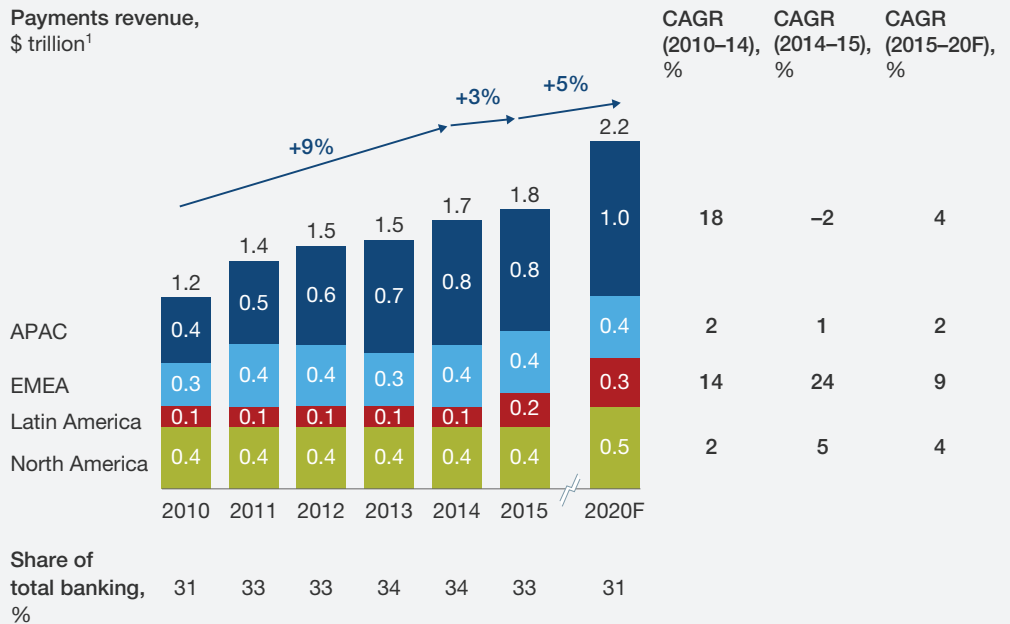
Payment fundamentals overshadowed by macroeconomic challenges

Most of the important payments fundamentals—transaction and account balance growth—continued on the solid path established in recent years. The headwinds faced by the payments industry in 2015 were largely attributable to the weak interest rate environment driven by economic uncertainty. Revenue trends for the industry in 2015 reflect the net effect of three combined factors:

- Payments volume growth remains strong: Both the number and the value of electronic payments transactions continue to grow at healthy rates, fueled by the continuing substitution of cash with electronic payments and rising financial inclusion rates. In 2015, the global number and value of cashless payments grew by 9 and 5 percent respectively, slightly above the 8 and 5 percent CAGRs over the period 2010 to 2014. Moreover, the digital (r)evolution provides clear tailwinds to this trend, although it also places additional competitive and price pressure on banks.
- Transactional account balances have never been higher: Despite low (in some cases negative) interest rates, both corporates and individuals continue to hoard cash in their transactional accounts—counter to classic economic theory. Outstanding balances on transactional accounts exceeded \$27 trillion by the end of 2015, their highest level ever. Even as interest rates fell to historically low levels in several geographies, transactional account balances enjoyed 7 percent growth in 2015, comparable to annual growth rates over the prior five years.

Exhibit 1

Global payments revenues increased marginally in 2015, and are expected to grow 5 percent per year over the next five years.



¹At fixed 2015 USD exchange rates, for the entire time series.

McKinsey&Company | Source: McKinsey Global Payments Map

- Interest rates reached historically low levels: After a small rebound in 2014 and early 2015 (in North America and the EU), when it seemed interest rates might have bottomed out, they fell again in several regions. While the EU and most Asian countries have been hit by continuous interest rate drops since mid-2015, with rates entering negative territory for a part of public and corporate debt in Europe, Latin America, and North America have not experienced such (additional) decreases.

McKinsey expects that these trends—that is, strong fundamentals in a low interest rate environment—will persist for the next three to five years. McKinsey expects global payments revenues to increase at an average annual rate of 5 percent for the coming five years (compared to our 6 percent forecast from last year), exceeding \$2 trillion by 2019, although macroeconomic and interest rate uncertainties could further affect performance in either direction. (Note that we have applied fixed exchange rates throughout this analysis using 2015 as the reference year.)

As a consequence, the share of payments revenues in global banking revenues is expected to decline. This trend began in 2015 with a decline from 34 to 33 percent, marking the first such reduction since the 2008 financial crisis, as low interest rates seem to have benefited banks' lending business. This trend should continue, with payments comprising 31 percent of banking revenues by 2020, matching 2010's revenue contribution level.

Pronounced differences in regional performance

The performance differences between regions are striking in terms of both absolute revenue

sources and sources of revenue growth. North America and Latin America continue to derive the majority of their payments revenues from domestic transactions and credit cards, mostly on the consumer side, while revenues in APAC are heavily driven by account-related liquidity, mostly on the commercial side. EMEA also relies mostly on commercial lines and account-related liquidity, although to a lesser extent than APAC. This reliance on liquidity-related revenues combined with shrinking interest rates explains the weaker performance of both APAC and EMEA in 2015 (Exhibit 2).

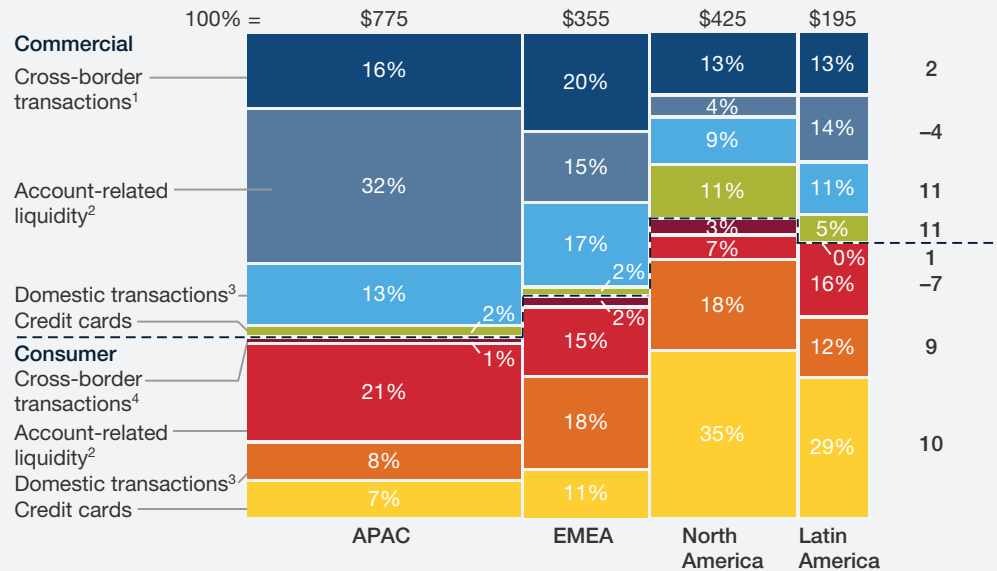
Latin American payments revenues grew at above 20 percent for the second straight year, making the smallest regional pool (at \$190 billion) also the most vibrant. This was the only region to enjoy noticeable net interest margin improvement. The addition of solid volume

Exhibit 2

Revenue sources differ across regions.

Payments revenue, 2015,
%, \$ billion

2014–15
year-on-year
growth,⁵ %



¹Trade finance and cross-border payment services.

²Net interest income on current accounts and overdrafts.

³Fee revenue on domestic payments transactions and account maintenance (excluding credit cards).

⁴Remittance services.

⁵At fixed 2015 USD exchange rates, for the entire time series.

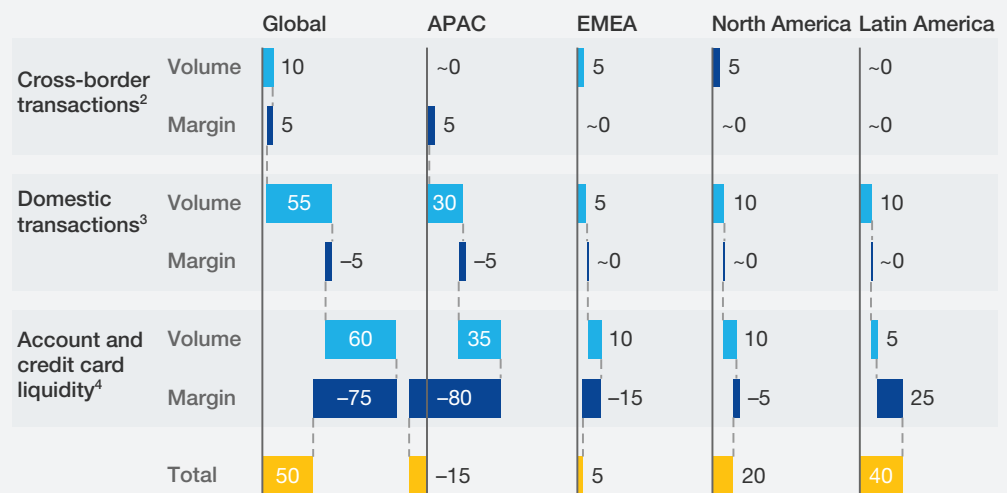
fundamentals (the number of cashless payments grew by 11 percent in 2015 to increase their overall share in total payments to 14 percent, up from 12 percent in 2014 and 9 percent in 2010), led to 24 percent revenue growth. Brazil generated 78 percent of Latin America's payments revenue growth despite having entered recession in 2015, and GDP contraction of more than 3 percent. Credit card revenues in Brazil accounted for more than half of the year's revenue increase, due to the expansion of both net interest margins and credit card loan balances. Brazil's earlier expansionary policies shored up payments growth during 2015, but there may be a compensating effect in 2016.

At the other end of the spectrum, APAC, the largest regional revenue pool at \$760 billion, posted a 2 percent decline after five years of 18 percent average annual growth. As APAC's revenues are heavily driven by account-related liquidity (mostly commercial), the net interest margin erosion (\$80 billion) wiped out the region's otherwise solid revenue gains, which were generated by strong volume growth in cashless transactions as well as higher transactional account balances (\$65 billion) (Exhibit 3). In China, the region's powerhouse, payments revenue

Exhibit 3

Growth in transactions was offset by a drop in liquidity margins.

Payments revenue growth decomposition, 2014–2015, \$ billion¹



¹At fixed 2015 USD exchange rates, for the entire time series.

²Trade finance, cross-border payments, and remittance services.

³Fee revenue on domestic payments transactions and account maintenance.

⁴Net interest income on current accounts, overdrafts, and credit card balances.

declined by 4 percent for the year, disproportionately affected by a sizeable contraction in transactional account net interest margin of 85 basis points. Japan, the third-largest revenue contributor in the region after China and India, also experienced revenue contraction driven by shrinking transactional account net interest margins. It masked favorable results in countries as diverse as India and Indonesia (each growing payments revenue 7 percent in 2015 as financial inclusion drove double digit increases in card payments and the number of transactional accounts), Singapore (11 percent revenue gains due to balance growth and interest margin expansion), and Australia (6 percent growth, for the same reasons as Singapore but at lesser magnitude). As demonstrated by these statistics, the region's geographic proximity does not result in shared economics.

After their first increase in four years in 2014, EMEA payments revenues plateaued in 2015 at \$355 billion, with the region posting 1 percent growth. EMEA faced many of the same challenges as APAC but given less reliance on account balances and less dramatic interest margin reductions, the drag on overall growth was less severe. Western Europe's payments revenues declined by 1 percent—two-thirds of the revenue loss came from Italy and Spain, mainly through net interest margin contraction. These countries did not perform appreciably worse than the rest of Western Europe, but drive a large share of the region's payments revenue. Meanwhile, revenue growth was strong in Eastern Europe (6 percent, driven almost exclusively by interest margins in Russia) and the Middle East/Africa (9 percent, through ongoing gains in financial inclusion and cash substitution).

Payments revenue grew by 5 percent in North America in 2015, well above its 2 percent average growth from 2010 to 2014. North America continues to derive nearly half its payments revenues from credit cards—far more than any other region—and has a significantly lower reliance on account-related liquidity.

Strong payments fundamentals drive favorable forecasts, but macroeconomic factors pose uncertainty

McKinsey projects a five-year CAGR of 5 percent for global payments revenues. The forecast calls for balanced and sustainable growth across regions: 2 to 5 percent each for APAC, EMEA, and North America. Even Latin America's projected 9 percent five-year CAGR reflects moderation from recent levels. The five-year projected CAGR of 5 percent (compared to our 6 percent projection from last year) outpaces 2015's 3 percent performance, but is well below the 9 percent CAGR seen between 2010 and 2014, which was fueled by the recession recovery and a particularly strong period of Chinese growth.

Payments fundamentals—volume and transaction growth as well as outstanding balance growth—remain robust and are expected to continue to spur revenue growth over the next five years. And, although interest rates are expected to remain low and possibly erode further in certain countries and regions, the magnitude of net interest margin compression will likely be much lower than in 2015 and should not offset the positive fundamentals to the extent they did

in 2015 (Exhibit 4). Continued challenges from non-bank attackers and increasing regulatory mandates will fuel persistent pressure on pricing (ie, domestic and cross-border transactions margins). As in past years, however, the ongoing shift from cash to digital payments—both domestic and cross-border—as well as routine GDP growth is expected to more than offset these negative factors.

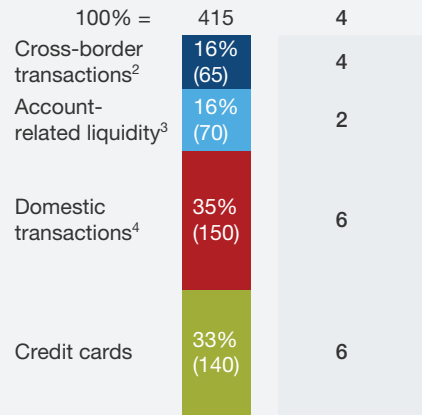
Domestic transactions and credit card revenues will be the primary drivers of global growth accounting for 35 and 33 percent respectively of absolute revenue growth between 2015 and

Exhibit 4

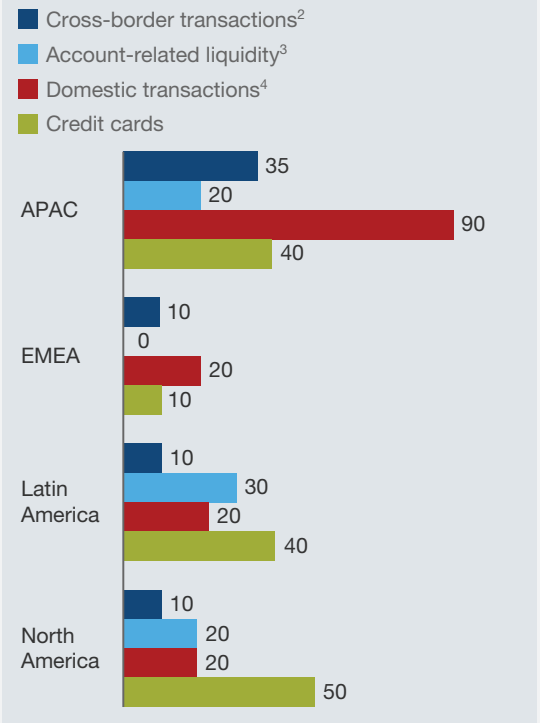
Revenue growth in liquidity and credit cards will be fueled by the Americas, while APAC will drive transaction growth.

Payments revenue growth decomposition, 2015–20, %, \$ billion¹

CAGR, 2015–20, %



Growth decomposition by region, 2015–20, \$ billion¹



¹At fixed 2015 USD exchange rates, for the entire time series.

²Trade finance, cross-border payments, and remittance services.

³Net interest income on current accounts and overdrafts.

⁴Fee revenue on domestic payments transactions and account maintenance (excluding credit cards).

2020. Domestic transaction growth will be heavily weighted toward the APAC region, thanks in part to the rapid conversion from cash to cashless transactions. As in past periods, North America and Latin America's payments revenues will be disproportionately driven by credit cards (both consumer and commercial), accounting for 51 and 29 percent of North America's and Latin America's absolute growth through 2020 respectively. At present, Latin America's card revenues are dominated by interest income, even more than in North America. This will be even more true going forward, as transaction fees will comprise a greater share of North American card revenues as transaction growth will outpace potential interchange reductions, and potential rebounds in interest rates are likely to compress card margins.

The good health of transaction-related revenues is a positive sign for the long-term resilience of the payments industry as such revenues are less exposed to changing macroeconomic and interest rate conditions, and are driven more by trends within the payments industry, which are more actionable for payments executives.

In contrast to domestic payments, cross-border payments revenue growth is expected to moderate over the next five years (4 percent compared to 6 percent for the period 2010 to 2014). This moderation will result from margin pressures as non-banks move more aggressively to gain share in this space.

Account-related liquidity revenues will drive only 16 percent of the revenue increase (down from more than half of the increase between 2010 and 2014), as balance growth will be dampened by expected continued interest rate declines. This is especially true in APAC and EMEA, where the growth contribution of account-related liquidity is expected to be extremely modest compared to the overall weight of account-related liquidity in total payments revenues.

This low contribution of account-related payments revenues obviously hurts near-term growth prospects. However, it will lead to an increasing reliance on transaction-related revenues, which is positive for the overall resilience and robustness of the payments industry.

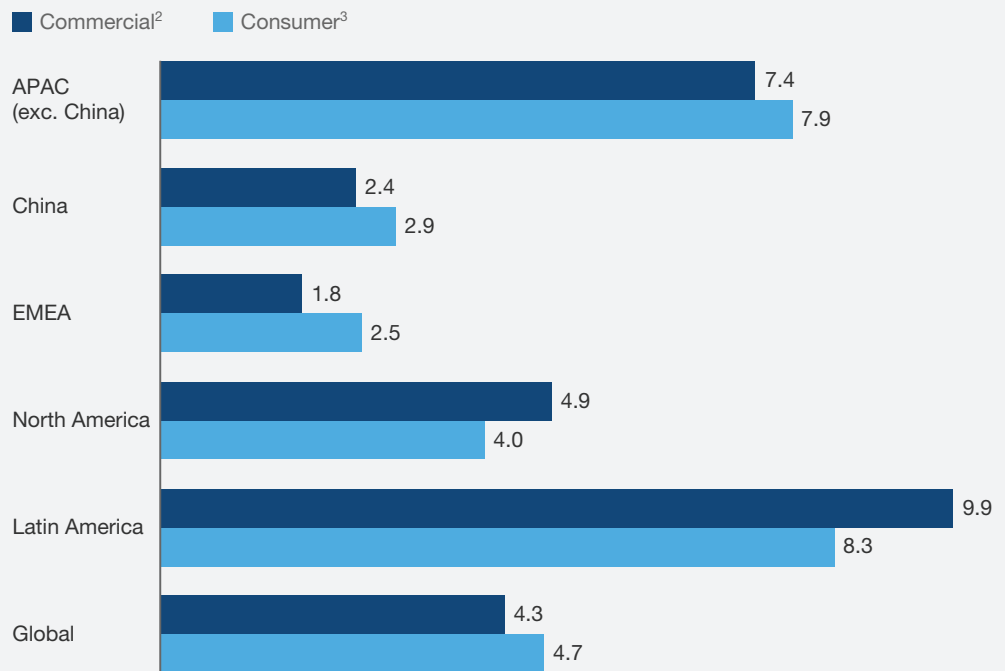
Finally, commercial payments revenues, which have been growing more robustly than consumer payments revenues for several years, are expected to lose some momentum in APAC and EMEA. The underlying reason is that commercial payments rely heavily on account-related revenues and cross-border fees, two revenue sources that are expected to face headwinds in the coming years (Exhibit 5).

Although McKinsey's five-year revenue growth forecast has been adjusted downward to 5 percent CAGR, the outlook remains quite impressive given that it is expected to be achieved without the benefit of the largest driver of recent growth—liquidity revenues. In many ways, the payments industry is better positioned now for long-term growth and stability, as the growth engines are more within payments executives' control. In other words, payments executives are more equipped to react to trends intrinsic to the payments industry, rather than

Exhibit 5

Pressure on liquidity margins is expected to adversely affect commercial payments revenue growth in APAC and EMEA.

Payments revenue growth, CAGR, 2015–20, %¹



¹At fixed 2015 USD exchange rates, for the entire time series.

²Revenue from commercial current accounts and overdrafts, commercial domestic payments transactions, merchant acquiring, cross-border payments, and trade finance.

³Revenues from consumer current accounts and overdrafts, consumer domestic payments transactions, card issuing, and remittances.

McKinsey&Company | Source: McKinsey Global Payments Map

macroeconomic trends like interest rate movements. Additionally, after another few years of nominal adjustments the interest rate environment should eventually shift direction (with the exception of Latin America, where rates remain relatively high), becoming a tailwind rather than a tether to growth. □

This article is an excerpt from the report *Global payments 2016: Strong fundamentals despite uncertain times*.

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