Look Who's Banking Now

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How productive can you be without access to credit? Only 63% of adults in emerging countries have a bank account either at a financial institution or through a mobile money provider, compared to 94% of adults in developed markets. That's around 1.7 billion adults who are classified as unbanked.[1] This represents a considerable catch-up opportunity as governments use technology to push their citizens into the formal economy, which, in turn, provides people with collateral, credit, and access to life changing financial tools and services. At the same time, financial inclusion should cut the inefficiencies of corruption and also improve tax collections for governments, which decreases fiscal deficits, benefits credit ratings, lowers the cost of borrowing, and boosts investment.

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EM counties should continue to post above average GDP growth rates due to their low base, and the tailwinds that come with marginal financial inclusion. Countries without proper frameworks, records, and enforcement of economic information and property rights face significant challenges in developing their economies.[2] Without these building blocks, citizens find it difficult to obtain credit, which puts constraints on capital, and limits growth. At the same time, without proper records, people will have a difficult time monetizing their assets. EM countries continue to grow despite these hurdles and we believe that marginal improvements in regulation and penetration in countries like Mexico, India, and Brazil could translate into significant GDP improvements.

COUNTRY	LOANS/ GDP (%)	MORTGAGES/ GDP (%)
Mexico	21.7	3.4
Indonesia	34.6	3.2
India	42.6	5.8
Russia	46.2	6.0
Brazil	47.4	9.5
Hungary	52.4	9.3
Philippines	56.3	3.9
Czech Republic	66.0	25.5
Poland	66.4	21.9
Turkey	76.0	6.1
South Africa	79.8	27.8
Thailand	79.9	22.4
Chile	90.3	25.9
Malaysia	117.5	39.0
China	153.6	28.4

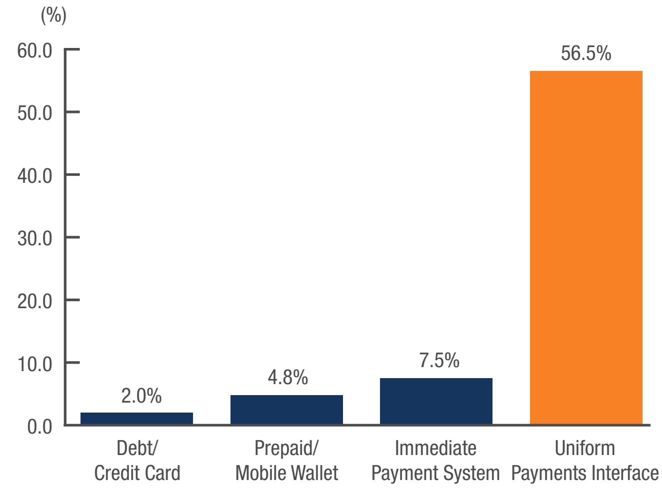
Source: UBS, GEM Banks Outlook 2019

[1]World Bank Group, "The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution."
[2]Hernando deSoto, "The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else."

India

The Indian government, under Prime Minister Narendra Modi, has made financial inclusion one of its top priorities. The Modi government has made significant progress in bringing the unbanked, especially those in rural areas, into the formal financial sector with the "Jan Dhan" banking initiative, which allows citizens to open zero balance bank accounts. In the last four years, Indians opened 330 million new savings accounts[3] and 80% of adult Indians now have bank accounts, up from only 53% in 2014.[4] The government has also tackled financial inclusion with the use of a biometric identification database, known as Aadhaar. Aadhaar provides each Indian citizen with a unique 12-digit identification number and can be used to open bank accounts, access government benefits, and make digital payments. Currently, 1.2 billion Indian citizens (over 90% of the population) are enrolled on Aadhaar[5] and it plays a key role in moving India towards a more digital society.

Select Digital Payment Growth Rates in India Following Demonetization

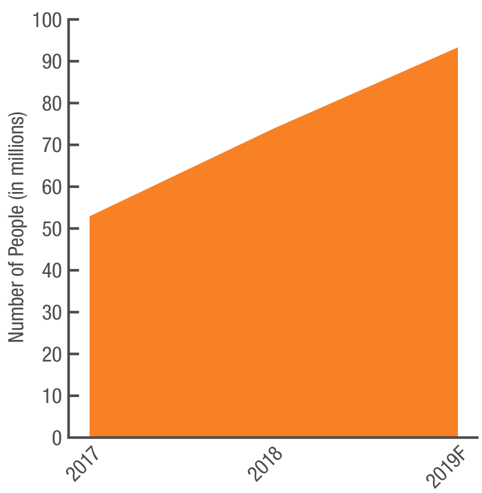


Source: RBI, Federal Reserve Bank of San Francisco

The adoption of digital payments is growing rapidly, fueled by government policies, the fast-growing number of internet and smartphone users, and the country's demonetization drive which invalidated billions of high-denomination rupee banknotes.

In 2016, the government launched Bharat Interface for Money (BHIM), a mobile payment app that uses the popular Uniform Payments Interface platform, which allows users to instantly transfer money between bank accounts for free. The adoption of digital payments is growing rapidly, fueled by government policies, the fast-growing number of internet and smartphone users, and the country's demonetization drive which invalidated billions of high-denomination rupee banknotes. In a country where cash is used almost exclusively in consumer transactions, demonetization created widespread disruption and immediately boosted the use of digital payments. According to eMarketer, 93 million people in India will make a payment from their mobile phones in 2019, an increase of roughly 19 million people from the year before. As India's digital ecosystem grows and evolves, we see tremendous opportunity for further innovation and growth.

Mobile Payment Usage in India



Source: eMarketer, October 2018

[3]World Economic Forum, "Financial inclusion in India is soaring. Here's what must happen next", Jan 2019
[4]World Bank Group, "The Global Findex Database 2017"
[5]IDinsight, "State of Aadhaar Report 2017-2018"

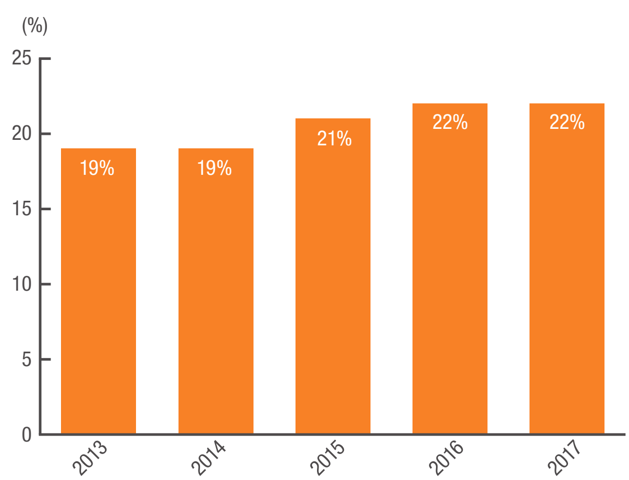
Mexico

While some may discredit Mexico for its mere 22% credit penetration (vs. 189% in the US[6]), we see this as a significant opportunity. The recently elected Mexican government has acknowledged that the lack of financial inclusion presents a headwind for economic growth. Though the 2013 labor reform (reducing the cost to fire someone, increased flexibility of formal job contracts, lower reporting costs, etc.) continues to gain momentum in growing the formal workforce, 57% of the employed population in Mexico still works in the informal sector.[7] Deputy Finance Minister Arturo Herrera says that fintechs, commercial banks, and government-controlled banks will all play a part in adjusting this economic landscape. "We will still have to create, or help create, a basic infrastructure that enables transactions between people or between people and financial institutions in some of the most rural, most disconnected areas of the country."[8] Parts of this could come with a mandatory fee reduction for lower income segments and other parts will come with a newfound focus on technology and connectivity between the government and the population (including payroll and welfare programs). Ongoing financial reform also includes measures to increase financial services penetration by enhancing the country's legal framework and fostering competition. These measures include a new digital payment platform called CoDi. CoDi could enable previously unbanked citizens to make P2P transfers and to pay for services such as Uber, Spotify and Netflix. CoDi will also allow citizens to pay at any establishment in Mexico using a smartphone. The catch is that one must open a bank account to enroll in the program. We believe that a boost to financial inclusion will improve formal employment rates, which will translate into improved tax collections and a healthier fiscal balance.

Mexico's credit penetration stands at a mere 22% compared to 189% in the US.

Property rights represent another driver of financial inclusion in Mexico. 55% of cultivated land in Mexico is still under Ejido status.[9] For context, following the Mexican Revolution in the early 20th century, up to two thirds of Mexico's land was re-distributed in a communal property structure known as "el ejido." The government eventually pushed through legislation allowing the privatization and sale of Ejido land in 1992, but this is a sluggish and ongoing process. We see a long-term structural opportunity in the ability for townships to continue to organize and allow people to divide and monetize their Ejido land, which will translate into newfound collateral, loan growth, and investment. The combination of increased financial inclusion and improved property rights can help bolster Mexico's economy.

Untapped Credit Penetration in Mexico



Source: JP Morgan Mexico 101: The 2018 Country Handbook, based on loans as a % of GDP.

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Brazil

We believe that Brazil will also benefit from financial inclusion, driven by more accessible banking systems and deeper housing penetration. Though 70% of transactions in Brazil still take place in cash,[10] a wave of banks, retailers, and tech companies are moving to address this opportunity. Brazilian companies are doing everything from launching cell-phone based P2P payment platforms, to QR reading technologies, to asset-light online-only banking (reducing the branch system). As formal financial tools become more accessible, we should see volume growth in loans, deposits, and various other financial products.

[6] JP Morgan, Mexico 101: The 2018 Country Handbook
[7] Ibid
[8] Reuters, August 2018
[9] Brittanica
[10] Citi Research

Mortgages can serve as a valuable tool to build credit history, and stimulate loan demand and investment. In Brazil, where demand for new homes outstrips supply, the government is trying to find new ways to help finance first time low-income homebuyers. Brazilian homebuilder MRV estimates that approximately 18 million new homes are needed to meet demand through 2040, on top of an existing 7.7 million unit housing deficit. This shortage is most acute in the low-income housing segment and is primarily driven by a lack of reliable financing options which stemmed from Brazil's history of hyperinflation and high interest rates coupled with limited financial inclusion. Brazil's Mortgage/GDP ratio still stands at 9.5% vs. 25.9% in neighboring Chile and 28.4% in China.[11]

Interest and Mortgage Rates in Brazil

Source: Bloomberg, JP Morgan, Banco Central Do Brasil.

[11]UBS, GEM Banks Outlook 2019
[12]World Bank
[13]Bloomberg, from Aril 2016 to March 2019
[14]MCMV Company

Only 16% of the adult population in Brazil has an outstanding loan to puchase a home.[12] Prospects of political change and fiscal reform have now opened the window for change. Historically, the combination of high and volatile interest rates made it difficult for individuals to borrow. With the central bank's key rate falling from 14.25% to an all-time low of 6.5%,[13] we now see increasing demand for credit and investment. In addition, other government-led initiatives have helped drive an improvement in housing accessibility in Brazil.

The MCMV (Minha Casa, Minha Vida — My Home, My Life) program in Brazil uses funding to subsidize home purchases for low-income buyers. Since 2009, the program has helped deliver over 5 million new contracted homes, over 3.6 million delivered new units, and total investments of R$294 billion across all income levels.[14] Despite the progress, Brazil still boasts significant scope for further development and financial inclusion.

Capitalizing on Financial Inclusion

Financial inclusion represents a key driver for economic growth across EM. From the micro side, it empowers individuals and companies to establish credit, borrow, and invest. On the macro side, it formalizes economies, improves tax collections, reduces fiscal deficits, and improves country credit profiles. For investors, financial inclusion creates attractive long-term investment opportunities based on both secular growth and idiosyncratic developments across financials, technology, housing, healthcare, retail, and education sectors. Identifying these developments requires the scrutiny, presence, and experience of an active, bottom-up manager like Mirae Asset.

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