Visa Business and Economic Insights

Special Economic Insight: Asia Pacific Inflation

Q4-2022: Edition 01

The Asia Pacific Inflation Playbook is a new offering from Visa Business and Economic Insights and Visa Consulting and Analytics (VCA).

This quarterly report will provide an update on the nearly unprecedented inflation shock and its implications on the economy, consumers and payments.

Additionally, VCA will offer guidance on available solutions and data to help contextualise and manage the challenges presented during this unusual period.

A once-in-a-lifetime inflation shock

Inflation has risen to levels not seen in around five decades.

Economists view inflation shocks as either transitory or permanent. Regulatory agencies and policymakers typically do not react to transitory shocks, which can include one-off adjustments to sales taxes, etc., as these generally do not unsettle inflation expectations.

A permanent inflation shock requires a policy response, such as raising interest rates, to reduce demand and bring the rate of inflation back to either the level of central bank targets or within a range that is considered low and consistent with stable inflation expectations.

This period bears the hallmarks of a permanent inflation shock:

1. The supply side of the economy has been disrupted by the invasion of Ukraine, China's zero-COVID policy and supply chains that (though improving) remain clogged and are slowing the mechanics of trade and production. These factors are unlikely to resolve soon.

2. The demand side of the economy was affected by the excess of stimulus thrown at individuals and businesses over 2020, the most intense period of the COVID pandemic. With the benefit of hindsight this stimulus appears excessive, and governments were slow to withdraw it.

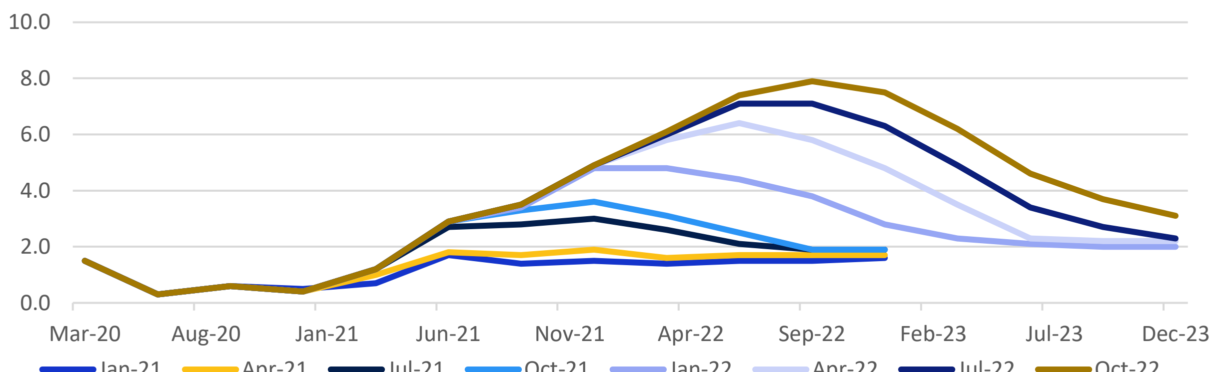
The latest forecasts from multilaterals such as the International Monetary Fund (IMF) suggest that disinflation will be slow and that higher prices will be here for an extended time.

Key Points:

- Inflation makes the economic outlook more challenging
- Payments will be impacted on multiple fronts
- Payments play a vital role in enabling consumer and merchant responses

Headline inflation forecasts for advanced economies

IMF has consistently revised the inflation rates upwards



Source: International Monetary Fund

Asia Pacific Inflation Monitor

Compared to the U.S. and Europe, inflation in Asia Pacific (AP) has been relatively benign in 2022. We attribute this to the late reopening of Asian economies after COVID, the economic slowdown in China and less-pronounced supply chain disruptions in AP, among other reasons. **Still, we expect a historically high inflation peak and a modest and protracted pace of disinflation in 2023. In other words, we anticipate at least two years of above-trend inflation in Asia.**

Inflation is expected to peak in 2022 for most AP markets and weaken in 2023 as demand starts to wane from the interest rate hikes and people start to adjust to higher input costs and supply chain disruptions. Notable exceptions include Mainland China and Hong Kong. Separate to this, the mechanics of the physical economy are locking up liquidity for longer as merchants try to bring goods and services to market.

At the moment, payment volumes are rising due to a combination of inflation (price effect) and pent-up demand (e.g., rebound in travel as mobility restrictions are lifted). However, in the coming quarters, we expect to see the following themes:

1. **Payment volumes should fall in discretionary verticals as incomes are rising at a slower pace.** Inflation and interest rates are expected to remain elevated for the next couple of years. Interest payments are likely to increase, which will eat into consumers' budgets. This is concerning because the housing loans in many countries are already elevated due to high housing prices.
2. **By their nature, nominal consumption and payment volumes of non-discretionary spend will be stickier than discretionary spend.** We expect to see a change in credentials used to finance non-discretionary spend.
3. **The intense period of COVID lockdowns during which loan balances were paid down could reverse.** Repayments could fall while balances are expected to rise. Consumers are currently borrowing from traditional lending lines and financing household appliance purchases. **We are already seeing a rotation to credit for everyday purchases such as fuel,** which has experienced huge price increases.
4. **Higher living expenses, such as rent, have eroded disposable income** and adversely impacted debit purchases. This makes large one-off purchases unaffordable, **increasing consumer demand for installment products.**

CPI*-all items	Asia Pacific	Australia	Mainland China	Hong Kong	India	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Jan-22	2.1%	3.9%	0.8%	1.2%	6.0%	2.2%	2.3%	3.0%	4.0%	3.2%	1.9%
Feb-22	2.2%	4.8%	0.8%	1.7%	6.1%	2.1%	2.2%	3.0%	4.3%	5.3%	1.4%
Mar-22	2.7%	5.7%	1.3%	1.8%	7.0%	2.6%	2.2%	4.0%	5.4%	5.7%	2.4%
Apr-22	3.5%	5.5%	2.0%	1.3%	7.8%	3.5%	2.3%	4.9%	5.4%	4.6%	2.6%
May-22	3.5%	6.1%	2.0%	1.3%	7.0%	3.6%	2.8%	5.4%	5.6%	7.1%	2.9%
Jun-22	3.9%	6.7%	2.4%	1.9%	7.0%	4.3%	3.4%	6.1%	6.7%	7.7%	3.4%
Jul-22	4.2%	7.0%	2.6%	1.9%	6.7%	4.9%	4.4%	6.4%	7.0%	7.6%	3.1%
Aug-22	4.2%	6.9%	2.4%	1.9%	7.0%	4.7%	4.7%	6.3%	7.5%	7.9%	2.9%
Sep-22	4.4%	7.3%	2.7%	4.3%	7.4%	6.0%	4.5%	6.9%	7.5%	6.4%	3.9%

Source: Haver Analytics
* Consumer Price Index

How can Visa Consulting & Analytics (VCA) help?

In this uncertain, inflationary macro-environment, banks and merchants will need to control costs, manage risks and continue investing in capabilities (e.g., digital) to differentiate their customer value proposition. VCA can help craft strategies and co-create solutions to navigate the themes covered in this report:

1. **Payment volumes should fall in discretionary verticals as incomes rise at a slower pace.** Banks and merchants will need to differentiate their proposition to win a greater share of higher ticket discretionary spend and control their operating expenses amidst rising staff salaries. VCA can help design firmwide loyalty programs that recognise, and reward customers based on their engagement history and life stage preferences. Additionally, firms can leverage VCA expertise to enhance their digital acquisition and digital engagement capabilities and sustain their unit economics.

2. **By their nature, nominal consumption and payment volumes of non-discretionary spend will be stickier than discretionary spend.** Banks and merchants will need to enhance their analytics capabilities to offset lag in traditional info sources and anticipate resilient spend categories. Firms can enhance their decision-making with custom VCA business intelligence solutions such as macro indicators, market benchmarks, customer personas and spend/travel predictors based on high frequency VisaNet data. Additionally, our economists can share deeper insights on payment trends in key markets/categories.

3. **The intense period of COVID lockdowns during which loan balances were paid down could reverse; we are already seeing a rotation to credit for everyday purchases such as fuel.** Banks will need to be vigilant for signs of declining savings and rising credit balances as leading indicators of potential customer defaults. VCA can help enhance risk modeling and management capabilities across topics such as underwriting, credit line optimisation, outstanding payment recoveries, portfolio stress testing and fraud management.

4. **Higher living expenses, such as rent, have eroded disposable income and adversely impacted debit purchases.** Banks will need to revamp their product offerings to service growing customer appetite for convenient credit (e.g., point-of-sale loans) and secure investments (e.g. term deposits). Banks can partner with VCA to co-create new credit/installment solutions or optimise existing portfolios. Banks can also capitalise Visa Managed Services for skilled resources to support on-ground initiative execution.

While banks and merchants focus on strengthening their core business to overcome near-term headwinds, it is also imperative for them to pay attention to secular trends such as Open Data, Net Zero and Web 3 and not lose sight of these transformational developments. VCA can be a natural thought partner and help you prepare for long-term business transformation.

About Visa Consulting & Analytics

VCA is a global team of payment experts, comprising of consultants, data scientists and economists. VCA has over 700 professionals, presence across 75 office locations, and executed over 1,200 projects in 2021.

- VCA consultants are experts in strategy, product portfolio management, risk, digital and more, with decades of experience in the payments industry.
- VCA data scientists are experts in statistics, advanced analytics and machine learning, with exclusive access to insights from VisaNet, one of the largest payment networks in the world.
- VCA economists understand economic conditions impacting consumer spending and provide unique and timely insights into global spending trends.

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