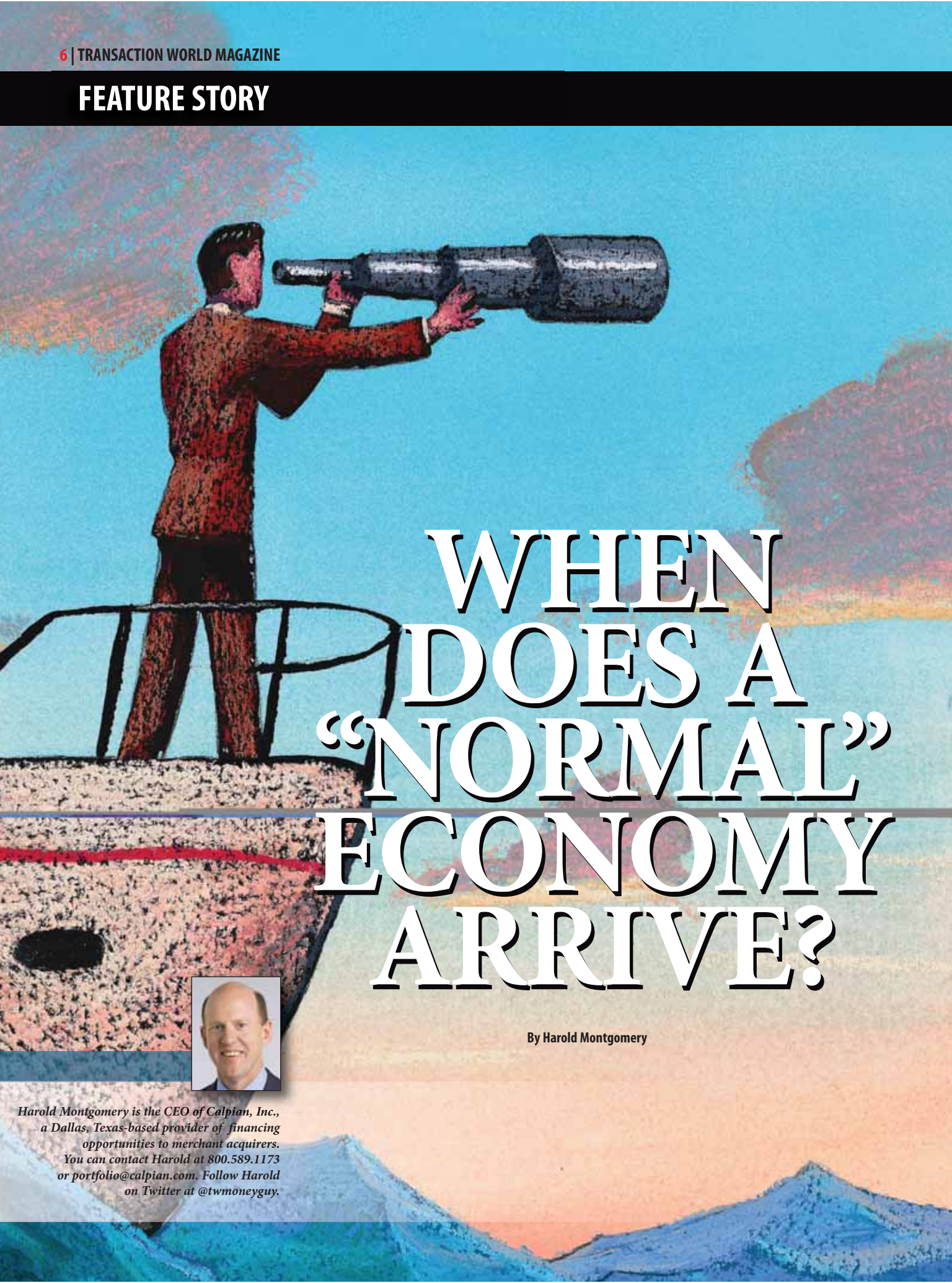


## FEATURE STORY

A man in a brown suit stands on the deck of a ship, looking through a large, dark telescope. The background is a bright blue sky with some light clouds. The ship's railing is visible in the foreground.

# WHEN DOES A “NORMAL” ECONOMY ARRIVE?

By Harold Montgomery



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For the last year or so, it seems to me that the electronic payments processing industry has been in a bit of a funk. Our business has penetrated the economy to such a level that it's become a utility and growth is tied to the overall performance of GDP. Furthermore, we took some lumps from the government on price regulation that were unhelpful if you are a bank, (to say the least) and scary as heck if you are an ISO (what will the government do next?)

Time was, years ago, processors and ISOs alike could count on growth from four sources – growth in the number of stores adopting electronic processing, volume growth as electronic payments substituted for cash, general sales growth due to a growing economy and, finally, growth in revenue coming from increasing numbers of services and increasing price points over time. This is a magical formula for business success and the results of almost 50 years of that kind of growth are all around us.

Time and the hard work of thousands of ISOs has taken away growth coming from an increasing number of stores – just about every store that needs electronic processing has it. Pricing has been tougher and tougher as merchants figured out how to get reduced rates for payment services through competition and government regulation. The substitution of electronic payments for cash still continues but the frontier here is small size transactions which don't have as much ability to lift revenue. Square is a good example of a product carving out a new frontier of micro-sized transactions. There might be money in it if they get enough micro-volume merchants, but that's not clear right now.

That leaves us with the economy as an important source of growth in processing volume and new merchant count. When will these two factors return to whatever normal is going to be? Over the last year, I have been looking through various economic statistics, searching for the indicator that suggests the economy is moving forward in a way that would help our industry overcome its current malaise.

The thing is, it's hard to find. Unemployment remains stubbornly high. In fact, I have begun to lose faith in the government's numbers of reported unemployment because I think they are losing track of people who have been out of the workforce for so long that they have lost faith and have re-classified themselves as permanently not working. That's a disastrous waste of human capital but quite common among certain education and age groups. Baby boomers who have enjoyed a growing economy for their entire lives are facing tragic economic circumstances that will be painful to deal with. Many of them are over 55 and won't work again in the formal economy no matter how much training they have.

The type of financial crisis we experienced that lead to the current slowdown was a classic bank/debt crisis fueled by increasing asset prices – mainly housing prices. Many people bought homes based on the size of the payment alone – ignoring the underlying price of the home or the cost of financing. They thought that as long as they could make the payment, everything would be fine. The problem is that as interest rates dropped, so did the payment amount for a given price. So as interest rates fell, the price of the house could go up and the payment wouldn't change much if at all. Buyers bought a more expensive house (read inflated price) with the same payment amount. That lead to millions of homes being

bought and sold for prices that were higher than the true market value. When the financially-driven price game ended, prices came down and all of a sudden there were millions of home owners who paid more than the new market price for their house. Oooops.

What does all this mean for the economy and our industry? A long wait to return to normal, apparently. According to the Federal Reserve, it takes more than a decade to fully recover from a banking crisis. When I first saw the chart below, I was astonished. How could it take that long? But as we've seen events unfold in the last few years, I get it – this thing will take a long time to unravel.

The chart I found from the Fed (below) shows the mean recovery time from a banking crisis. So far the U.S. is tracking the trend line of other economies that have had similar crises – and perhaps a bit slower.

From my reading of the chart, a full recovery could take another three to as many as seven years. The average recovery chart line (red) shows that even eight years after the crisis, the typical experience is that the economy is 8% lower than the pre-crisis trend. Ouch. Of course, there's no telling how much economic value we lost as a result of the crisis – what would have been created without it and will never be made back up again.

It's clearly going to take a while. ■

