Santander

ECONOMICS

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Brazil Credit Report

It's Not for a Lack of Credit – Part I: Individuals

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- **Although many believe the credit market is playing a significant role in the difficulties faced by the economy in recovering its pre-crisis growth rate, the data show a different reality:**
- **Total new loans to individuals grew 7-9% YoY in the first half of the year, well in line with the evolution of retail sales in the same period.**
- **We further note that loan quality is evolving favorably, as longer-term and lower-cost modalities (i.e., payroll-guaranteed and auto financing) are expanding faster than loans that are usually sought by individuals during emergency situations.**
- **The Brazilian Central Bank's Quarterly Credit Survey of financial institutions shows that the recovery can be attributed to both supply and demand factors.**
- **Unfortunately, the trucker drivers' strike will likely generate worse data in the next few readings, in our view, though we expect this to be temporary. Nonetheless, our analysis suggests that the fundamentals for a credit recovery as a driver of economic activity are solid and should prevail throughout 2H18.**

Figure 1.
Growth in Loans to Individuals (Total) and in Retail Sales (both in real terms)

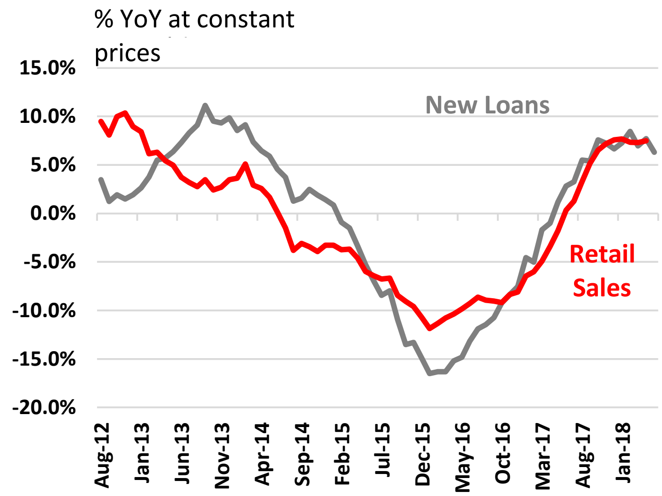
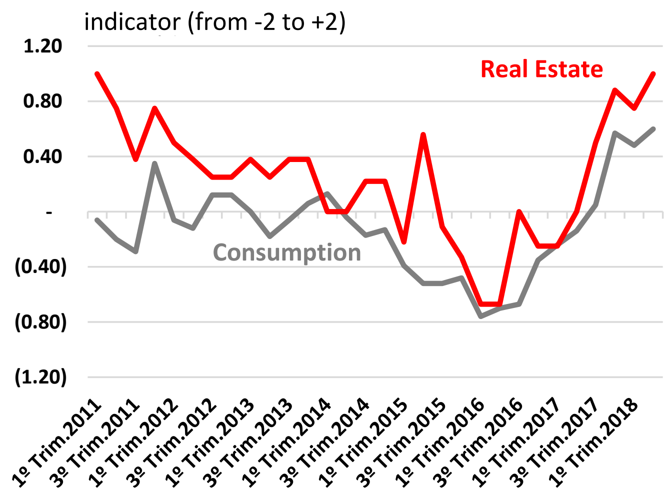


Figure 2.
Quarterly Credit Survey
Demand Observed



Sources: Brazilian Central Bank and Santander estimates.

Introduction

While we see Brazil's economy as showing clear signs of a rebound after the severe depression observed in 2015 and 2016, we also believe that the pace of recovery has been slower than expected. Some aspects that could suggest more substantial economic growth are related to the credit market, namely: (i) restrictions in loan supply (mainly from public banks); (ii) fragile demand due to excessive indebtedness; and (iii) high financial burden (stemming from insufficiently reduced final rates to borrowers).

Our more careful analysis of the available data, presented below, refutes the concept that credit has acted to constrain the recovery. In this report, we evaluate the recent evolution of credit stock and the indicators of propensity to offer funding by financial institutions, as well as the perception of demand. We also explore regional and sectoral aspects of borrowing behavior.

Unfortunately, we expect the truck drivers' strike to generate worse data in the next few readings. Nonetheless, our analysis suggests that the fundamentals of the credit recovery as a driver of economic activity are solid and should prevail throughout 2H18.

More Credit to Demand Recovery

The stock of credit available to individuals has already shown above-inflation growth since the middle of last year, with new YoY loan growth of 7-9%, well in line with the evolution of retail sales in the same period. Figure 3 illustrates these dynamics and also shows that the current **credit recovery seems to precede the inflection of economic activity, contrary to what typically happens when the economy loses steam (as was the case in 2013).**

The data set reinforces the perception that monetary policy easing has been passed on to consumers through greater availability of funding. In fact, the reduction of the Selic rate helped lower the availability of household income committed to debt service, creating room for the beginning of a new increased indebtedness cycle (as shown in Figure 4). **Although the inflection is clearly seen in Figure 4, we believe that the growth rate of the credit stock as a proportion of income remains moderate, which corroborates our idea that there is great potential for the continuity of this process in the coming years.** The current debt-to-income ratio, at 41.3%, remains far from the 46.4% peak in April 2015, just before the economy plunged into recession.

Figure 3.
Growth in Loans to Individuals (Total) and in Retail Sales (both in real terms)

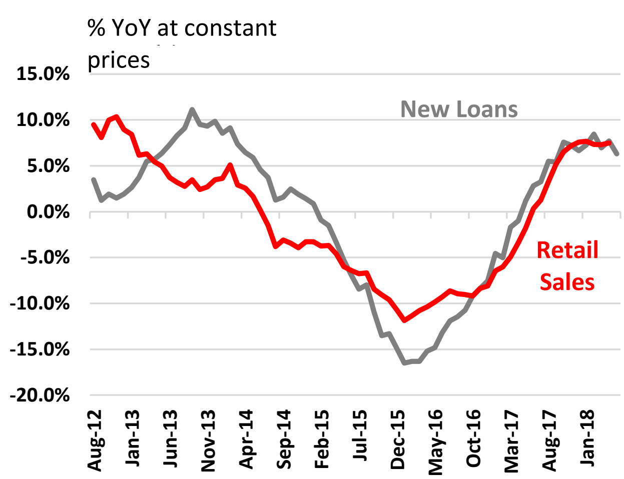
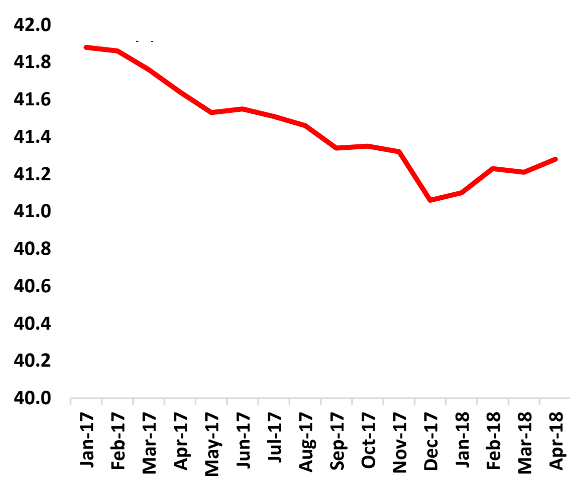


Figure 4.
Household Indebtedness (annual income %)



Source: Brazilian Central Bank.

In addition, loan quality is evolving favorably, as longer-term and lower-cost modalities (such as auto financing and payroll guaranteed) are expanding faster than loans that are usually sought by individuals in emergency financial situations, such as payroll-guaranteed loans and revolving lines (credit cards and overdrafts) – see Figure 5. Nevertheless, we note that revolving credit statistics include transactions carried out with credit cards and settled on demand. The stock of transactions that incur high interest rates, in practice, already shows a downward trend, as illustrated in Figure 6.

Figure 6 also illustrates the dynamics of the recovery of economic growth across sectors. At first, this is supported by the demand for automobiles and durable goods. **The expansion of housing credit is still moderate, though it should become a major growth driver by the end of 2018, in our view, benefiting from the lowest interest rates in the last 60 years.**

Figure 5.
Growth in Loans to Individuals - Revolving and Other Modalities (both in real terms)

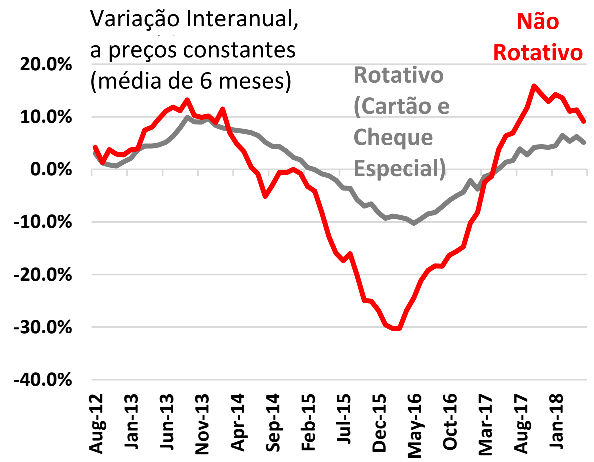
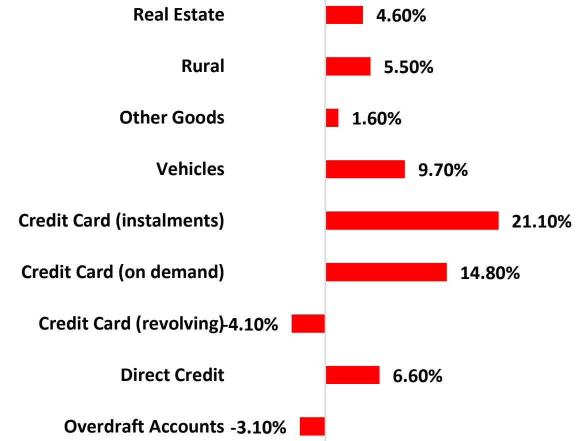


Figure 6.
Growth in Loans to Individuals by Modality (May-2018/May-2017)



Source: Brazilian Central Bank.

Our final assessment is that the recovery shown by the data is due to factors related to both supply and demand. At least this is what is revealed by the Brazilian Central Bank's Quarterly Credit Survey of financial institutions (as illustrated in the graphs below).

In both housing credit as well as consumer credit, we notice that most of those surveyed find that current conditions are expansionary, a trend that has shown growth in recent quarters. Thus, it seems clear to us that the improved confidence and reduced household income committed to servicing debt has provided a significant push to the propensity to consume through loans.

On the supply side, we see that the availability of mortgage loans has lost steam in the last few readings, likely because of the market volatility witnessed since the beginning of the year. **We acknowledge that the stabilization of international conditions and the final resolution to the political scenario tend to increase the supply of funding in the housing segment.**

Figure 7.
Quarterly Credit Survey
Demand Observed

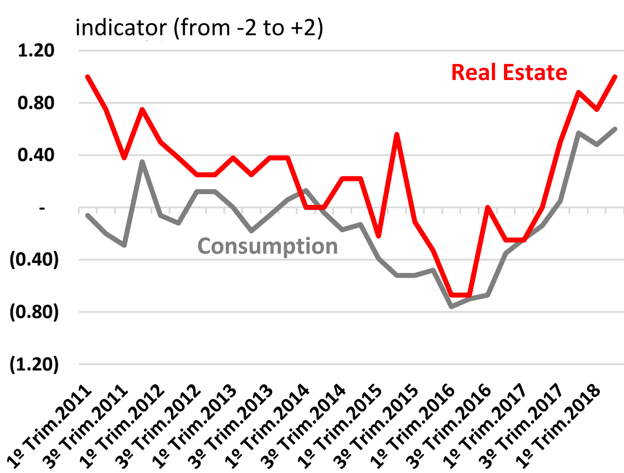
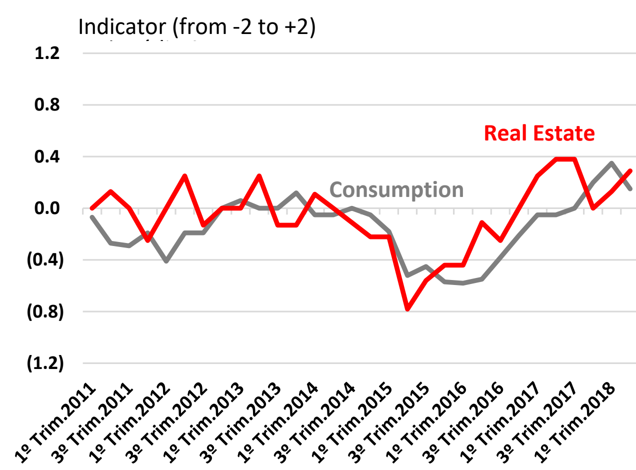


Figure 8.
Quarterly Credit Survey
Supply Observed



Source: Brazilian Central Bank.

Conclusion

Although many believe that common sense would dictate that the credit market should play a significant role in helping the economy recover to its pre-crisis growth rate, the data show that on both the demand and supply side, conditions are quite favorable. Loans to individuals seem to be fulfilling the role of bolstering consumption, which should, in our view, translate into investments.

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