Santander

Brazil **July 20, 2018**

Credit Report

It's Not for a Lack of Credit – Part III: Delinquency, Way Better than It Seems

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- **We recently released two credit reports that highlight the strengths related to supply and demand in this market over the first five months of the year, both for households ("It's Not for Lack of Credit – Part I: Individuals" July 18, 2018), and for companies ("It's Not for Lack of Credit – Part II: Companies", July 20, 2018).**
- **We argued that, although the truck drivers' strike in May reduced GDP growth projections, the credit market's good fundamentals suggest a positive outlook for recovery throughout the second half of 2018.**
- **Our analysis of delinquency reinforces this thesis.**
- **Data released by the Brazilian monetary authority unequivocally illustrates, in our view, substantial and widespread improvement in indebted individuals and companies' ability to meet their payment obligations during 2017, and persisting into early 2018.**
- **The continuity of the substantial contraction, at the margin, of the stock of provisions suggests that delinquency indicators as a percentage of credit should resume their downward trajectory during the second half. This conclusion seems even more valid for companies, whose stock of unpaid debt has fallen at a rate of 4% in the last three months.**

Figure 1. Change in the Stock of Resources Considered Delinquent (year-on-year %), Public and Private Banks

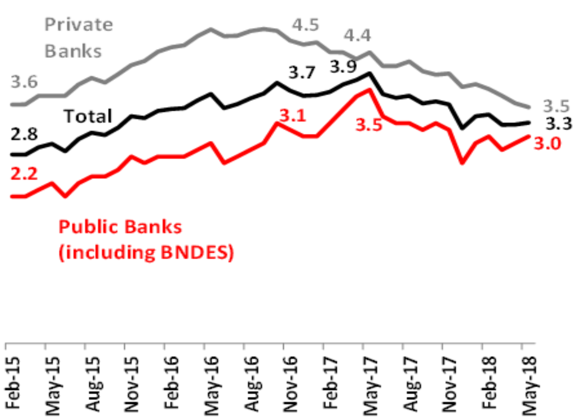
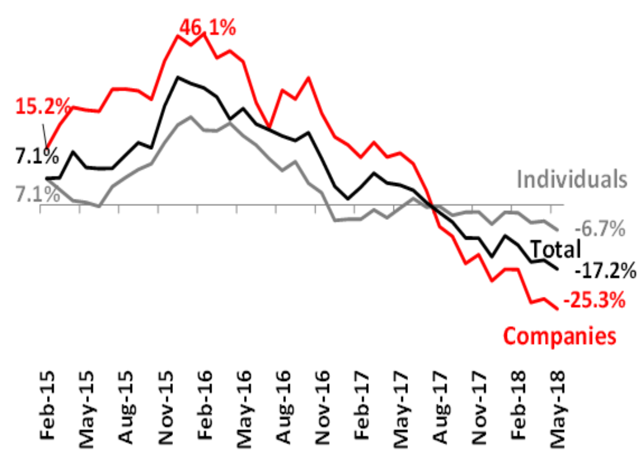


Figure 2. Change in the Stock of Resources Considered Delinquent (year-on-year %), Individuals and Companies



Source: Brazilian Central Bank.

Introduction

We recently released two credit reports that highlight the strengths of supply and demand in this market over the first five months of the year, both for households ("It's Not for Lack of Credit – Part I: Individuals", July 18, 2018), and for companies ("It's Not for Lack of Credit – Part II: Companies, July 20, 2018). We argued that, although the truck drivers' strike in May reduced GDP growth projections and certainly led to distortions in indicators for the period immediately following the strike, the credit market's good fundamentals suggest a positive outlook for a recovery during the second half of 2018.

Our analysis of delinquency, detailed below, reinforces this thesis.

Delinquency in a Consolidated Downtrend

Data released by the Brazilian monetary authority unequivocally illustrates, in our view, substantial and widespread improvement in indebted individuals and companies' ability to meet their payment obligations during 2017, and persisting into early 2018. As we have already pointed out, in the case of companies, it is relevant to evaluate the differentiated dynamics between loans granted by private banks and those offered by public banks (especially the BNDES). In the first case, the reduction is much more intense and less volatile, while in the second, the delinquency/asset ratio seems to have fluctuated near stability in the initial months of 2018, which could suggest a weakening trend (see Figure 3).

We highlight that public banks continued to act aggressively in the early moments of the recession, in contrast to the caution of private institutions, which anticipated the more challenging scenario that materialized in 2015 and 2016. As consequence, the inflection of the delinquency indicator of the former came almost a year later than the latter (Figure 3 astutely illustrates this point).

Likewise, it is interesting to observe the dynamics of the recovery in lending, reflecting and, at the same time, affecting the improvement in delinquency indicators, which occurred earlier for private institutions than public institutions.

Figure 3. Delinquency Rate (Credit Stock %) Public and Private Banks

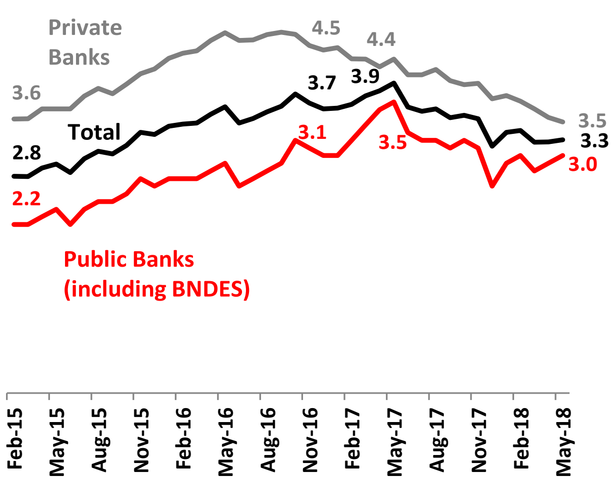
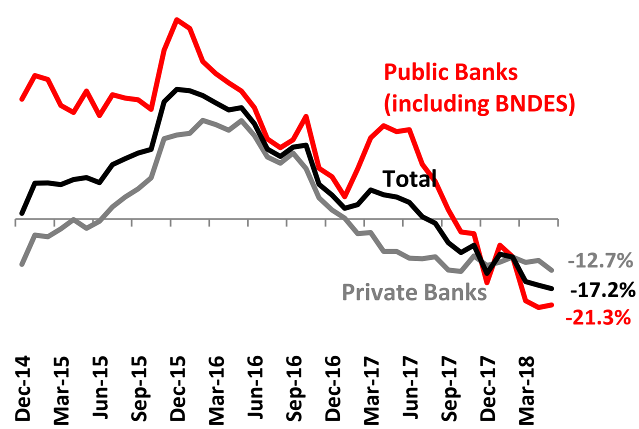


Figure 4. Change in the Stock of Resources Considered Delinquent (year-on-year %), Public and Private Banks



Source: Brazilian Central Bank.

An alternative way of analyzing what is happening with households and companies' ability to pay off their debt is to eliminate the denominator effect, that is, to evaluate just the behavior of the stock of delinquent balances. Figure 4 (above) shows the year-on-year change in this balance. Notice how significant the magnitudes are: total reduction of 17% in the stock of delinquent funds in May 2018, compared to the same month of the previous year.

Considering that the data, at the margin, continue to show a decrease in the stock of loans considered delinquent, the stabilization or recovery of credit growth expected for the second half of 2018 will certainly lead to further reductions in delinquency/asset statistics.

The analysis of the data broken down by individuals and companies allows for similar conclusions: while the delinquency rate appears to have stabilized in both cases over the last few months (Figure 5), the continuation of the contraction, at the margin, of delinquent amounts suggests that the indicators tend to resume the downward trajectory. This conclusion seems even more valid for companies, whose stock of unpaid debt has fallen at a rate of 4% in the last three months.

Figure 5. Delinquency Rate (Stock %)
Individuals and Companies

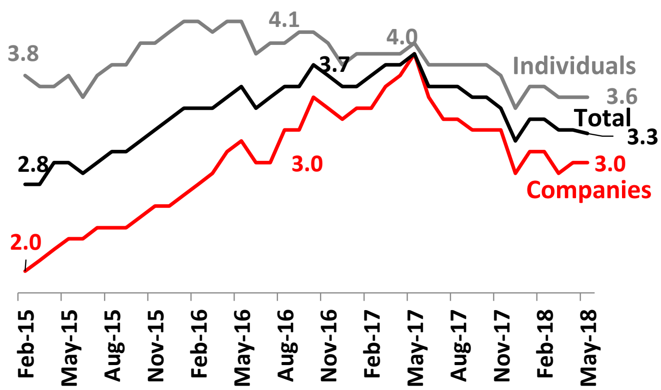
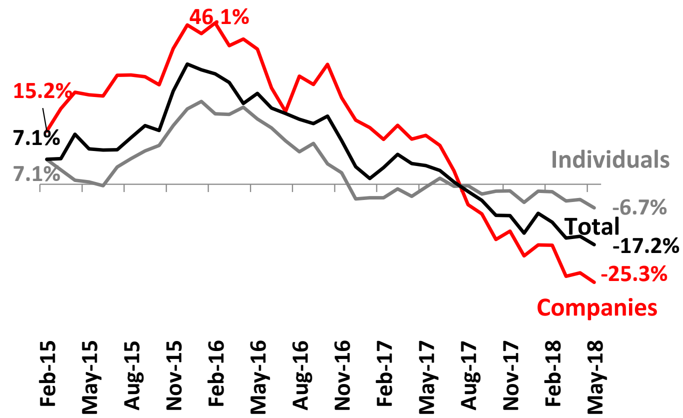


Figure 6. Change in the Stock of Resources Considered Delinquent (year-on-year %), Individuals and Companies



Source: Brazilian Central Bank.

Another factor that we believe will affect the delinquency dynamics in a favorable way is the recent approval of the positive register. The system tends to cheapen the cost of credit by reducing information asymmetry. The biggest beneficiaries, with lower credit costs and greater access to credit, are likely to be small and medium borrowers and creditors, given the reduction in system inefficiencies. Studies conducted for the U.S. economy indicate that there could be a reduction of up to 40% in delinquencies registered, over a number of years, as a result of the implementation of a positive register structure.

Conclusion

As with credit performance in early 2018, the data suggest a trend of declining delinquency over the course of 2018, despite the temporary loss of steam by the economy that should characterize the months of June and July. The improvement in the financial situation of individuals and companies, as well as the approval of the positive register tend to contribute to increase the supply of funds and sustain the recovery of economic growth in the coming years.

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