How sky-high interest rates are choking economic growth in Brazil

By: Flavio Lobato

Despite ranking as the ninth-largest economy in the world, Brazil hasn't been on par with other emerging economies when it comes to GDP growth rates. In recent years, the Brazilian economy has flatlined. For the sake of comparison, United States GDP is roughly ten times the size of Brazil's and continues to grow at a faster rate. India's GDP, similar to Brazil's, is growing three times faster. How do we explain this discrepancy?

Brazil remains insular, with 85 percent of its GDP based on domestic consumption and industry. International trade represents only 15 percent of the total economy. The world mistakenly regards Brazil as a commodities country, due to the overrepresentation of commodity sectors on the São Paulo stock exchange.

In reality, the Brazilian economy is fairly similar to the U.S. economy, where domestic consumption rules GDP growth. However, unlike U.S. consumers, Brazilians have very limited access to fairly priced credit.

Over-expensive credit

Credit cards and installment credit are widespread, with over 77 percent of households exposed to them in some way. Over 60 percent of e-commerce is paid for in installments, and 64 percent of Brazilians cannot afford to make purchases without spreading the payments over several months.

And while the Central Bank lowered the Selic benchmark interest rate from 14.25 percent to a historic low of 6.5 percent in recent years, annual consumer rates for credit cards topped 270 percent for unpaid balances. As Brazil suffered its worst economic crisis in history, the banks raised credit card rates to a stunning 500 percent per annum on unpaid bills.

With Brazilians relying on credit and paying for everything from everyday goods to luxury items in installments, massive interest rates are being embedded into these payments.

Credit card v. interbank lending rates

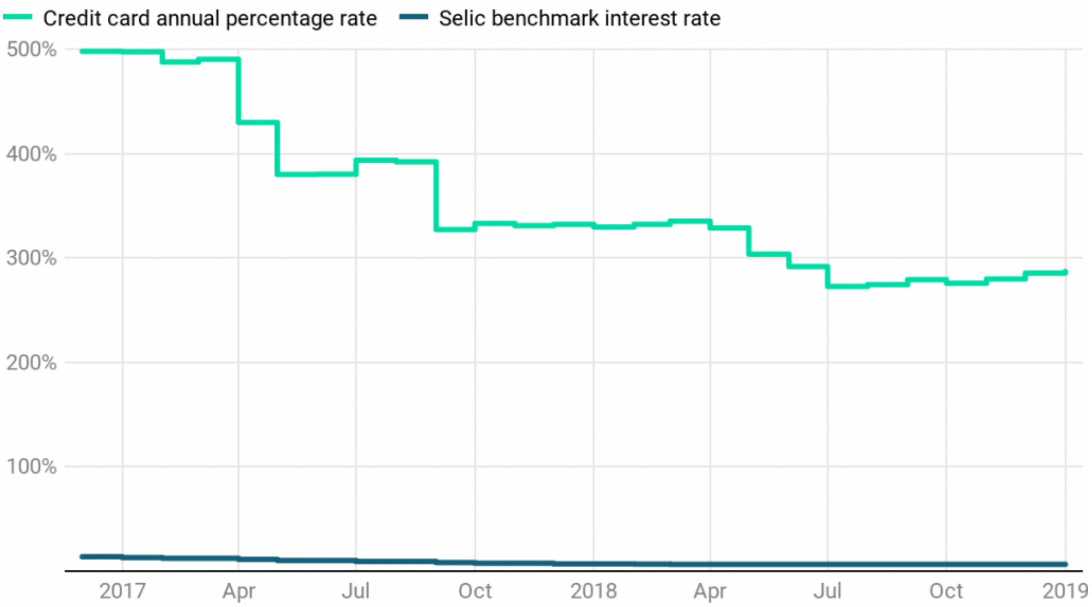


Chart: THE BRAZILIAN REPORT • Source: CENTRAL BANK • Get the data • Created with Datawrapper

Therefore, it's not so much the level of debt that is hurting Brazilian consumers, rather the percentage of interest paid from disposable income. When looking at the Brazilian economy, low debt levels can be misleading because high interest rates aren't being taken into consideration. What looks like a small and harmless use of credit can blow up into a huge dent in disposable income.

This lack of access that Brazilian consumers and middle-market companies have to fair credit rates is one of the main causes for Brazil's subpar GDP growth rates.

This massive charge to the consumer is hurting the overall economy in a significant way. If we assume that, under fair circumstances, the natural growth level of the Brazilian economy would equal that of India, we could suggest that the cost of low growth due to absurdly priced credit is approximately USD 100 billion a year.

Until the economic plumbing is unclogged and companies and consumers are able to access interest rates that match the rest of the developed world, growth rates will remain stagnant.

Why are interest rates so high in Brazil?

Over 80 percent of the Brazilian credit market is controlled by five large banks, two of which rank among the top five companies by market cap on the São Paulo stock market. Additionally, the government is the largest debtor in the country and sucks up the majority of available credit, leaving little for consumer and middle-market companies.

Until recently, reserve requirements on deposits were kept at 40 percent but have now been lowered to 25 percent. While this move should improve lending availability, it's still a far cry from the 3-to-5 percent reserve requirements in countries such as the U.S., where the Federal Deposit Insurance Corporation insures depositors for up to USD 250,000. In Brazil, bank failures regularly wipe out depositors, forcing regulating agencies to enforce large reserve requirements and in turn, increase the cost of credit.

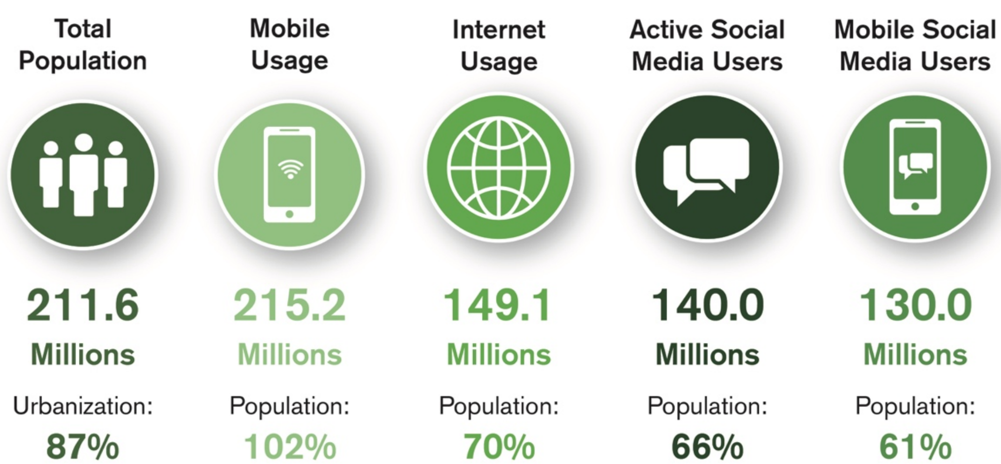
Main types of debt in Brazil

% of households that have each type of debt

Chart: THE BRAZILIAN REPORT • Source: FLAVIO LOBATO • Get the data • Created with Datawrapper

The overall lack of investments in infrastructure, education, and healthcare have also greatly contributed to an inefficient market and subpar economic growth rates. This underscores the need for a better understanding of how much poor credit costs the economy.

Over 55 million Brazilians lack access to basic bank accounts and make most of their transactions in cash and bank-issued invoices, a system regulated by the Brazilian Federation of Banks. Using these invoices is safe, but it is also expensive and inefficient for companies to accept, as each one must be authenticated, formatted as a letter, and mailed to each payee.



Source: Joao Kepler

Opportunity for disruption

The Brazilian installment market is ripe for disruption. As of 2016, installment credit stood at BRL 353 billion (USD 100 billion). This represents just over half of all credit granted to consumers.

Brazil has a well-developed banking system that dates back to the hyperinflationary years of 1980–1994, and it has sophisticated internet and cellular networks that are used by huge portions of the population. The chances for well-funded fintechs to enter and disturb Brazil's cozy credit market is one of the most significant and promising fintech opportunities today.

With rough calculations placing installment credit revenues at over USD 200 billion, it's no wonder large banks are fighting hard to maintain the status quo.

It's time for the newly elected leadership to deregulate and open the consumer credit market. This will allow for technology and entrepreneurship to work their magic and set Brazil back on its intended growth path.