

**BRAZIL: CREDIT GROWTH MODERATED AND MAINTAINED KEY DISPARITIES IN 2013**

February 12th 2014

**2013 in review: Slower overall credit growth, with important disparities**

Credit growth to the private sector slowed to 8.7% year-on-year in real terms in 2013, continuing the gradual deceleration trend from 2011 in the context of weak economic activity, deteriorated—though gradually improving—asset quality, and tightening financial conditions. Real loan growth to individuals slowed to 10.4% from 11% in 2012, while corporate loan growth decelerated to 7.3% from 10.3% in 2012. The stock of outstanding credit, which grew to R\$2.7trn in December, continued to increase as a share of GDP; it rose to 56.5% from 53.8% at end-2012. (Figure 1.)

Sizeable growth pace disparities persist in regards to the supply of credit and type of lending. As government-controlled banks have assertively enlarged their market share, directed (earmarked) lending to individuals and companies has firmly outpaced non-directed (non-earmarked) lending.

Asset quality broadly improved, with the total 90-day non-performing loan ratio falling to 2.97% from 3.68% at end-2012. Still, the quality of credit varies by segment. The NPL ratio is higher for individual (4.43%) vs. corporate (1.83%) loans; non-directed (4.76%) vs. directed (0.9%) loans; and loans issued by private banks (4.22%) vs. public banks (1.84%).

**Government-controlled banks are driving directed credit flows**

Credit flows to the private sector continue to be led by public banks, which increased lending during the 2008/09 global financial crisis to stimulate the economy and, since 2011, have been pressured to boost allocations to spur the credit market and reduce wide spreads. (Figure 2.) Indeed, public banks supplied 71.5% of credit flows to the private sector in 2013, followed by private domestic banks (17.5%) and private foreign banks (11%). Public banks' market share of the outstanding credit stock held by the private sector now stands at 48.5%, up from 33% at end-2007. The market share of private domestic banks has dropped to 35.1% from 44.7% over the same period, and that of private foreign banks has fallen to 16.4% from 22.3%.

The development bank BNDES—which has received more than BRL300bn in capital injections from the Treasury and tripled its outstanding credit stock since 2007—has led the expansion of public banks. Yet, other government-controlled banks—including Caixa Econômica Federal (CEF) and Banco do Brasil (BB)—have also increased lending. In 2013, BNDES' total outlays rose 16% in real terms and other public banks increased lending by over 20%.

At the same time that lending growth is being led by public banks, there has been an important shift in the type of lending allocated to the private sector. Growth of directed loans to individuals and companies is expanding at a faster pace than growth of non-directed loans. (Figures 3 and 4.) In 2013, total directed loans rose 18.6% in real terms while non-directed loans rose 1.9%. Directed loans are typically issued at subsidized rates and, thus, are less responsive to the current monetary tightening cycle than non-directed loans.

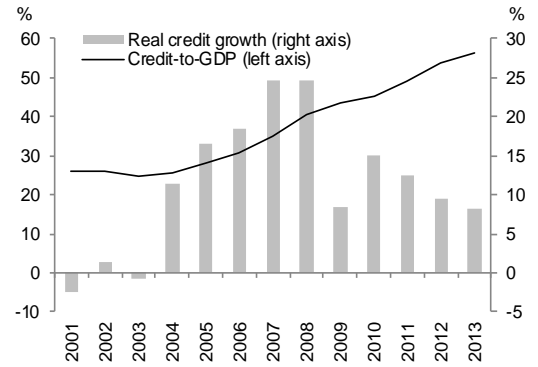
Public banks have been behind the expansion of directed lending through long-term corporate credits granted by BNDES and home loans issued by CEF and BB. In 2013, BNDES' total disbursements to industry and investment rose 16% and 12%, respectively, in real terms. The government's intention was to raise investment via a combination of BNDES lending, tax breaks, and a weaker BRL to boost industry, but fixed investment has not picked up due to deteriorated fundamentals including slow growth, high inflation, and uncertain investment climate. (Figure 4.)

Mortgage loans, issued by other public banks, rose 27% in 2013 to a low base of 8% of GDP. This strong growth is supporting many first-time home owners, but is also maintaining households' debt service at an elevated level and providing no relief to over-leveraged consumers. (Figure 3.)

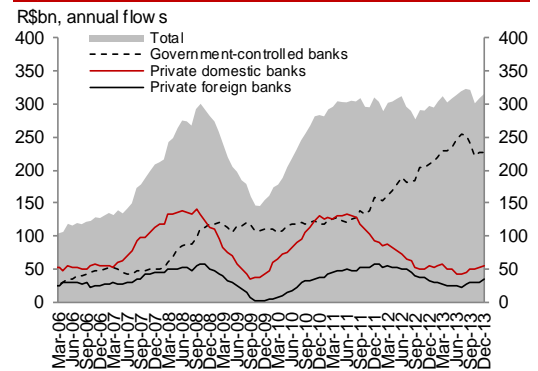
**Gap between public and private bank lending should narrow in 2014, but at slow pace**

One of the government's main policy choices in 2014 is whether—and by how much—to pull back public banks' lending. It will be difficult for public banks to sustain their robust pace of lending growth without placing further pressures on fiscal deterioration and inflation. Public banks began to undertake a gradual retreat in the last months of 2013, with their lending growth slowing to 16.3% yoy in December from an average of 20% yoy in the first nine months of the year in part due to teller strikes. An intentional moderation of public bank lending would mark a needed policy improvement but it remains unclear if the government intends to deliver a well-defined policy shift to recover fiscal credibility, maintain its sovereign credit rating, and assist the Central Bank in containing inflation. Public banks' pull back is likely to be gradual in 2014 in the midst of an election year, weak GDP growth, and BNDES' central role in financing planned infrastructure projects.

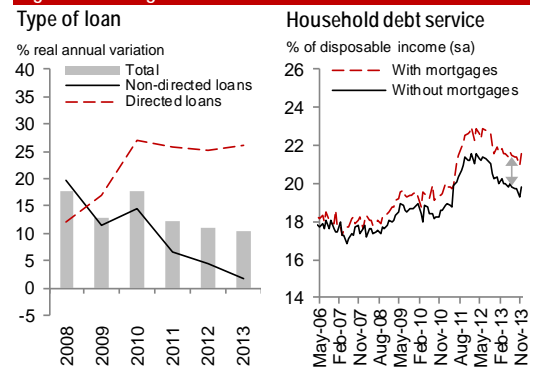
**Figure 1: Credit to the private sector**



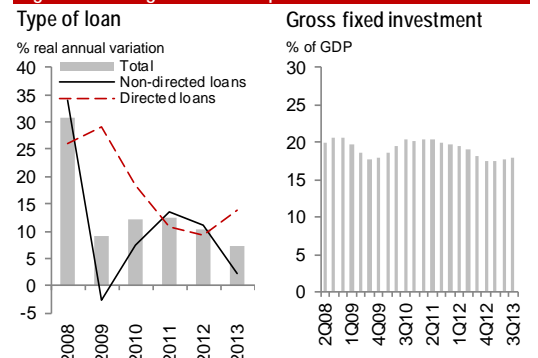
**Figure 2: Credit flows to private sector by lender**



**Figure 3: Loan growth to individuals**



**Figure 4: Loan growth to companies**



Source: Central Bank; IBGE; BTMU Economic Research (NY).



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