BTMU LATIN AMERICA TOPICS

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BRAZIL: THE OUTLOOK FOR CONSUMPTION

December 24th 2013

Moderated consumption growth

While private consumption—which accounts for two-thirds of Brazilian GDP—has maintained its resilience as the main growth driver of the economy in the near term, it is expanding at a moderated pace in an environment of elevated inflation, lower real wage gains, and slowed credit growth. Also, although the unemployment rate is at its record low, job creation has begun to display weakening. In the context of an expected gradual deterioration of the labor market and a decelerated credit market, the outlook is for slower consumption growth than in recent years.

Real private consumption grew 2.8% in the four quarters through 3Q13, below the annual average growth of 4.9% that was recorded in 2004-12 upon solid fundamentals, favorable labor and credit market dynamics, and expansion of the middle class. In the absence of drivers to sustain a noteworthy acceleration, consumption is expected to grow 2.5% next year. (Figure 1.)

Low unemployment rate, but weakening job creation

The very tight labor market has been a key factor supporting the resiliency of Brazilian private consumption since 2011 amid the sub-par pace of GDP growth. The unemployment rate was at 4.6% in November, according to figures released last week. In seasonally-adjusted terms, it was at 5.1%, falling from 5.3% in October and registering a new historical low.

November's labor market result is noteworthy because it marked the second consecutive month in which the fall in the unemployment rate was not accompanied by an increase in employment growth; in fact, the unemployment rate did not rise because the working population fell. (Figure 2.) In October and November, the working population contracted 0.5% yoy and 1.0% yoy, respectively. Job creation is finally showing signs of slowing. Employment growth contracted 0.7% yoy in November, with activity slowing in the industry and services sectors.

It is to be expected that the tight labor market should begin to deteriorate since GDP growth remains below potential. With the drop in the labor force likely to be temporary on account of favorable demographics—the population is expanding at rate of 1%—weaker job creation may prompt a gradual upward trend in the unemployment rate in 2014.

Eroding real wage gains

The growth rates of nominal and real (inflation-adjusted) wages maintain upward momentum, albeit at a moderated paces. The real average wage rose 3.0% yoy in November, on account of strong nominal adjustment. However, stronger real wage growth is being compromised by the dynamic of below-potential economic activity and high inflation, which is now into its third year.

The real wage rose by an average of 1.8% year-on-year in the 12-months through November 2013, slowing from an average of 3.5% in 2006-12. (Figure 3.) At the same time, the wage-inflation dynamic is not helping to reduce inflation pressures. Services inflation remains high, with the 12-month rate still hovering above 8%.

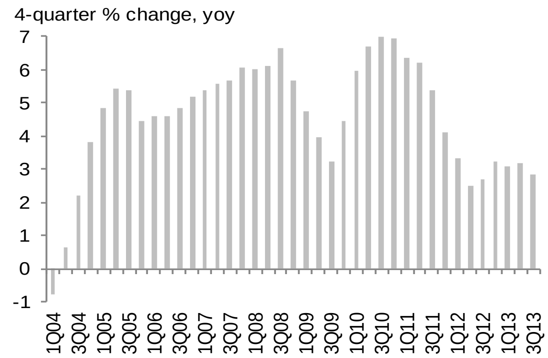
The nominal minimum wage adjustment is also less generous than in recent years. In Brazil, the formula for adjusting the nominal minimum wage is determined as the inflation rate of the previous year plus the GDP growth rate from two years prior. Accordingly, owed to weak GDP growth, the nominal wage adjustment was 9% in 2013 and 14% in 2012. For 2014, the increase should be around 6.9%. This would equate to a real minimum wage adjustment of around 1.3% in 2014 (assuming that inflation lowers to the Central Bank's 4Q13 Inflation Report projection of 5.6%), below the adjustments of 3% in 2013 and 8% in 2012.

Decelerated credit market

Following a robust credit deepening cycle from 2006-12, the Brazilian credit market is constrained on the supply and demand sides. The slowed credit market continues to test the resiliency of consumption, as we have been noting since last year.

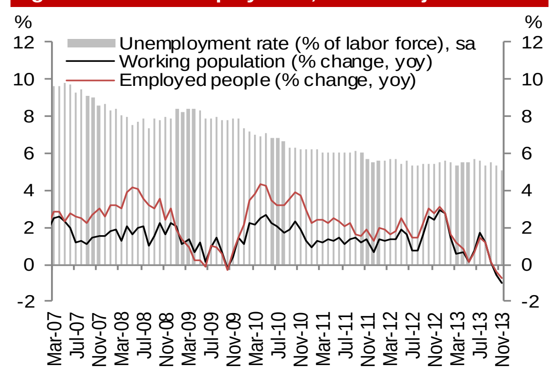
Real credit to individuals grew 10.6% yoy in November, cooling from average growth of 12.4% in 2012 and 14.9% in 2011, per data released by the Central Bank last week. (Figure 4.) Brazil's indebted consumers still need to deleverage. Outstanding household debt as a share of annual disposable income reached 45.4% in October, the highest on record. Moreover, despite the slight recent decline, one-fifth of households' disposable income is still directed to pay principal and interest obligations. (Figure 4.) Credit quality is slowly improving at private banks but, with the Central Bank raising the SELIC to contain inflation, the debt service burden is unlikely to fall soon.

Figure 1: Real private consumption



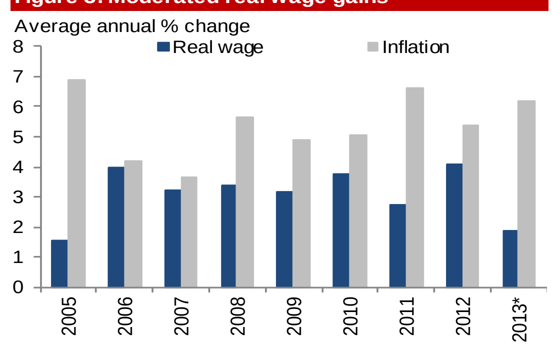
Source: IBGE; BTMU Economic Research.

Figure 2: Low unemployment, but weak job creation



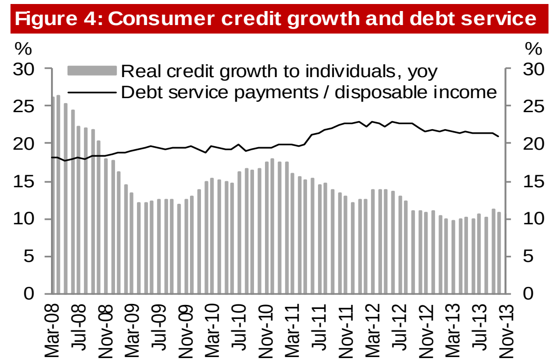
Source: IBGE; BTMU Economic Research.

Figure 3: Moderated real wage gains



Note: (*) 12m thru Nov '13. Source: IBGE; BTMU Economic Research.

Figure 4: Consumer credit growth and debt service



Source: Central Bank; BTMU Economic Research.

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