



LATIN AMERICA ECONOMICS UPDATE

Brazil: is a corporate debt crisis brewing?

- **The dramatic rise in borrowing costs in Brazil in the past few years appears to be causing debt problems at a growing number of companies. So far at least, there is little evidence of widespread stress and the banking sector looks well placed to deal with rising non-performing loans. But higher debt servicing costs are likely to result in weaker business investment and slower GDP growth.**
- The bankruptcy of major retailer Americanas last month has been in the headlines and, while that should be an isolated event (the catalyst for the bankruptcy was an accounting scandal), scrutiny of Brazilian corporates has reportedly increased and credit conditions have tightened.
- In the meantime, a growing number of companies appear to be struggling with debt payments. Airlines and retailers, in particular, seem to be hurting. And media reports suggest that the central bank and government are considering dusting off pandemic support measures for banks and corporates.
- **So far, the economy-wide data suggest that strains are building, but not severely.** The non-performing loan (NPL) ratio on corporate non-earmarked loans (i.e. lending made at market-based interest rates) has risen from 1.5% in 2020 to 2.3% in January, but that's still low by past standards. And arrears data, which have been a good leading indicator for the NPL ratio, don't point to a sharp pick up. (See Chart 1.)
- Meanwhile, corporate dollar bond yields have increased, particularly for high yield (i.e. below investment grade) companies. (See Chart 2.) The spread between high yield and investment grade dollar bonds has widened particularly sharply in the last few weeks and is now at its highest level since 2016, suggesting that stress might be emerging at some lower-rated corporates. (See Chart 3.)
- **The good news is that Brazil's corporate sector isn't coming off a large credit boom** – something that has often been the trigger for private sector debt crises across EMs in the past. Total outstanding non-financial corporate credit is no higher as a share of GDP than it was in 2016. (See Chart 4.)
- **The problem, instead, is that interest rates have risen dramatically.** The central bank hiked the Selic rate by a whopping 1,175bp in its tightening cycle and [appears unlikely](#) to lower interest rates for some time. By our estimates, Brazil's private sector faces one of the largest increases in debt servicing costs of any emerging market this year. (See our [Emerging Markets Focus](#).) On the corporate side specifically, lending rates have increased by more than 10%-pts from their low point in late 2020. (See Chart 5.) And the interest rate on corporate loans is often indexed (to inflation or short-term interest rates), particularly compared with consumer loans, where a higher share of loans are issued with fixed interest rates.
- Historically in Brazil, borrowing costs have rarely risen as sharply as they have done in the past couple of years. That said, there are a couple of episodes over the past two decades that we can analyse when corporate borrowing costs rose by around 10%-pts or more within the space of a few years: in early 2003 and in early 2016. **In these historic cases, the NPL ratio on corporate loans rose by 1.5-3.0%-pts.**
- **Those increases aren't particularly dramatic. And this time around, there are reasons to think that the outcome might lie at the milder end of the spectrum.** [Estimates](#) suggest that the likely amount of corporate debt to be restructured is smaller than it was during the 2014-16 economic crisis. Moreover, high commodity prices should support the revenues of many of the country's largest companies. And although retailers appear to be struggling, [rapid wage growth](#) should provide a floor for consumer spending.
- **What's more, Brazil's banking sector looks well placed to weather a period of rising bad loans.** The banking sector enjoyed a sharp rise in net income last year and is well capitalised. (See Chart 6.) And, by our calculations, banks have a high capacity to absorb loan losses. (See our [Emerging Markets Update](#).)
- **But higher debt servicing costs are likely to translate into weaker investment and growth.** In the two prior cases in which corporate lending rates rose sharply, identified above, fixed investment fell by 5-7% in the following two quarters. While we doubt investment would fare as badly this time around (commodity prices are higher and the political environment is not as chaotic), it does suggest that **the risks to our GDP growth forecast of 1.0% this year are skewed to the downside.**



Chart 1: Corporate Loan NPL Ratio (% , Non-Earmarked Loans)

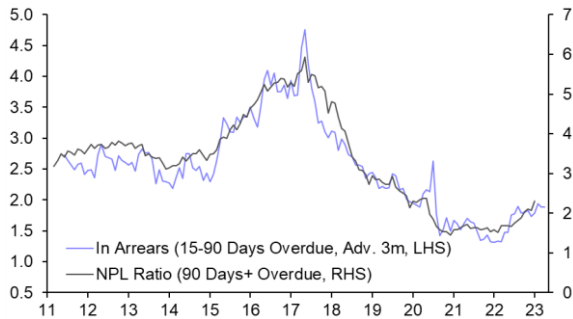


Chart 2: Yield of ICE BofA Brazil Corporate Dollar Bond Index (%)

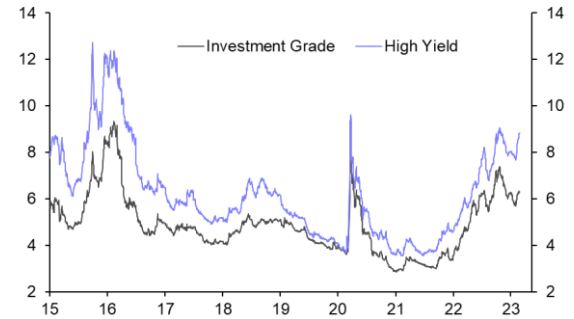


Chart 3: Spread Between ICE BofA Investment Grade & High Yield Brazil Corporate Bond Indices (bp)

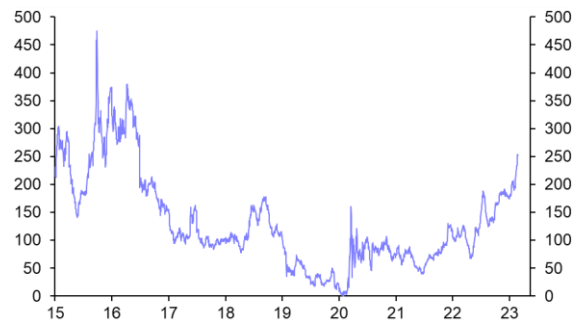


Chart 4: Total Non-Financial Corporate Outstanding Credit (% of GDP)

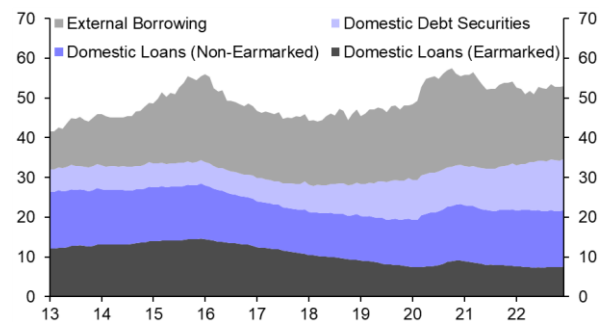


Chart 5: Lending Rates on New Corporate Loans (%)

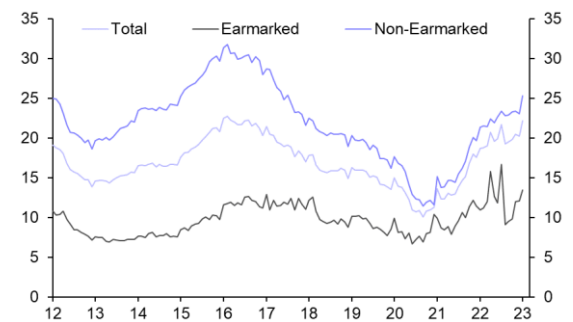
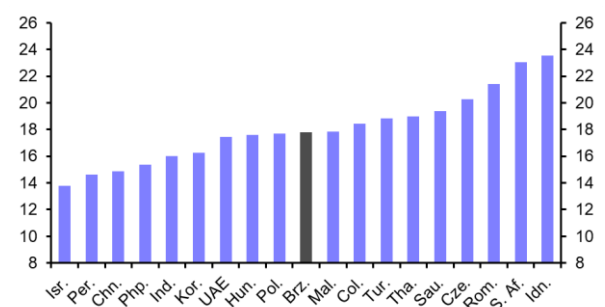


Chart 6: EM Banks' Regulatory Capital (% of Risk-Weighted Assets, Deposit-Taking Institutions, Q3 2022)



Sources: BCB, Refinitiv, Capital Economics



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