Frame by Frame: Brazilian credit data for June 2020

The Brazilian Central bank releases private sector credit information monthly. For the month of June (released on July 29), improved asset quality across the board was a positive surprise, given the operating environment, as was a slower deceleration in non-directed lending. Higher NPL coverage ratios indicate, however, that 2Q results could be under some pressure – though lower rates are a bigger medium-term risk.

The highlights were:

- Total financial system loans reached R$3.6 billion, representing 9.8% growth yoy (+60 bp mom). The acceleration was largely driven by stronger growth in directed lending, especially to companies, which offset a deceleration in non-directed lending to companies.
- Asset quality, as measured by the 90-day NPL ratio, improved 30 bp bp mom to 2.9%. Improvement in quality was broad-based, driven in particular by mortgages and working capital loans.
- New loan origination trends, which are indicative of future growth, weakened, with new loans originated in the last 12 months growing 11.1% yoy, down 70 bp mom. On a seasonally adjusted basis, originations were up mom, indicating that yoy trends reflect softness from early in the COVID-19 crisis period.
- Rates on newly originated loans continued to decline, reaching 19.3% (-120 bp mom), driven by mostly by non-directed loans to individuals (in particular credit card installment loans).

	Value	Growth		
June 2020	(R$ bn)	Yoy	Δ mom	Δ qoq
Loans/credit				
Total non-financial sector	11,066	14.5%	+96 bp	+146 bp
Total non-financial private sector	6,328	16.8%	+89 bp	+33 bp
Financial system loans	**3,625**	**9.8%**	**+57 bp**	**+21 bp**
Non-directed	2,115	14.9%	-79 bp	-342 bp
Non-directed individuals	1,107	8.9%	-10 bp	-668 bp
Non-directed companies	1,007	22.4%	-175 bp	+65 bp
Directed	1,510	3.3%	+211 bp	+424 bp
Asset quality and coverage				
90-day NPL ratio	**2.9%**		**-30 bp**	**+290 bp**
Non-directed	3.7%		-35 bp	-18 bp
Non-directed individuals	5.2%		-30 bp	0 bp
Non-directed companies	2.0%		-40 bp	-30 bp
Directed	1.7%		-39 bp	-46 bp
Provisions to loans	6.8%		+1 bp	+16 bp
90-day NPL coverage ratio	238%		+2,830 bp	+2,538 bp
LTM new loan originations				
Total	4,037	11.1%	-69 bp	-431 bp
Non-directed	3,680	11.2%	-97 bp	-551 bp
Non-directed individuals	1,875	7.2%	-105 bp	-747 bp
Non-directed companies	1,805	15.7%	-87 bp	-330 bp
Directed	357	9.7%	+214 bp	+741 bp
Rates on newly originated loans				
Overall	**19.3%**		**-120 bp**	**-340 bp**
Non-directed	27.6%		-167 bp	-501 bp
Non-directed individuals	40.8%		-210 bp	-560 bp
Non-directed companies	13.0%		-120 bp	-360 bp
Directed	5.2%		-9 bp	+2 bp
Penetration (as of May 2020)				
Debt service ratio (DSR)	21.5%		-10 bp	+120 bp
Loans to GDP	50.4%		+80 bp	+160 bp

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FRAME 1. Loan growth: Holding on through the cycle

Cyclical trends: Some resiliency

Loan growth showed some resiliency despite the unfavorable backdrop. While much of that was a factor of stronger directed lending (the BNDES being slightly more active, especially in working capital loans), non-directed loan growth decelerated less. This slower deceleration was driven by a normalization in growth for loans to companies (which jumped in March as companies tapped into their outstanding credit lines as the COVID-19 crisis gained speed).

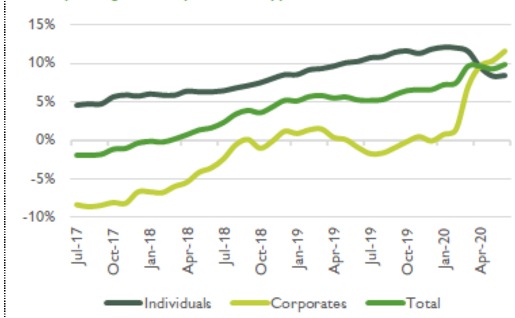
On the consumer side, there was also more resiliency, and even some recovery (credit card installment growth recovered as spending started to resume). For other loan products, yoy growth appears to have at least stabilized – and at a likely more sustainable level than pre-COVID.

Overall, system growth is likely to remain close to current levels or slightly lower until the end of 2020 – both from the perspective of caution from the banks and from the base for comparison.

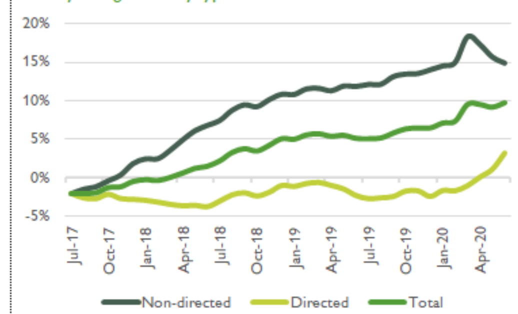
Structural forces: A bit of relief

With the COVID-19 bump, DSR had climbed to the highest levels since 2017. These levels should decline, in part helped by lower rates.

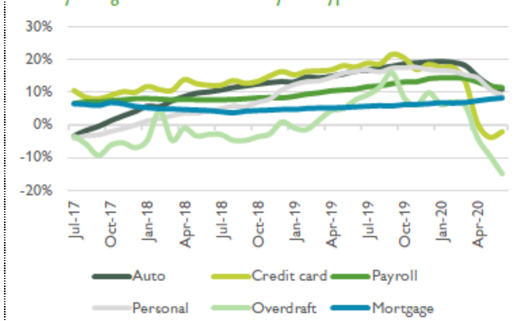
1.1. Yoy loan growth - by borrower type



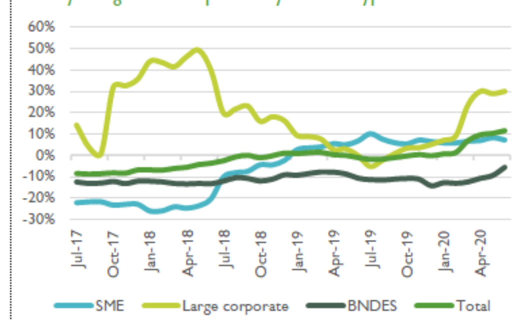
1.2. Yoy loan growth - by type of loan



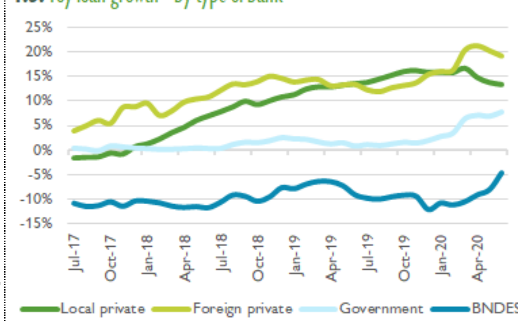
1.3. Yoy loan growth - individuals - by loan type



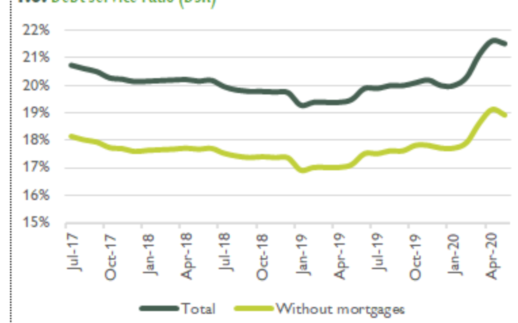
1.4. Yoy loan growth - companies - by borrower type



1.5. Yoy loan growth - by type of bank



1.6. Debt service ratio (DSR)



Source: Brazilian Central bank.

FRAME 2. Asset quality: A surprise improvemen

Cyclical trends: Surprising relief

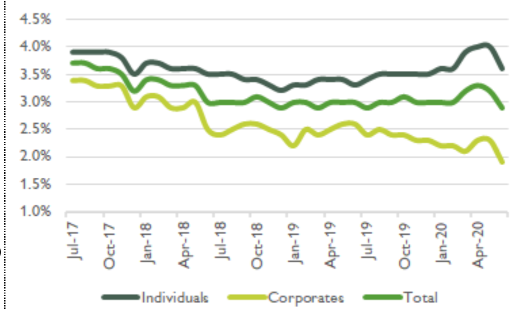
The broad-based improvement in asset quality likely was driven by a greater number of renegotiations of loans by the banks (backed by Central bank regulations), which allowed the loans not to be considered past due but still forced banks to keep their provisions (as the credit ratings on the loans do not change until they show performance after renegotiation). This pushed the NPL coverage ratio to an all-time high.

Yoy growth in NPLs showed the same trend, continuing the deceleration started in May and now trailing the pace of yoy growth for loans. It is clear that the system is in flux and not operating with observable trends, but regardless the results are positive.

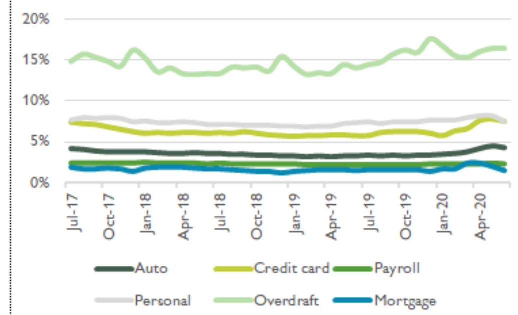
Structural forces: Back to recent levels

NPL ratios returned to levels seen for much of the 18 months prior to COVID-19 and could go lower as banks pull back from new originations. That said – two factors should remain top of mind: further improvement from current levels in the medium term will be more mix-driven than quality driven and banks will likely start releasing provisions (and boosting returns) once COVID-19 phases out.

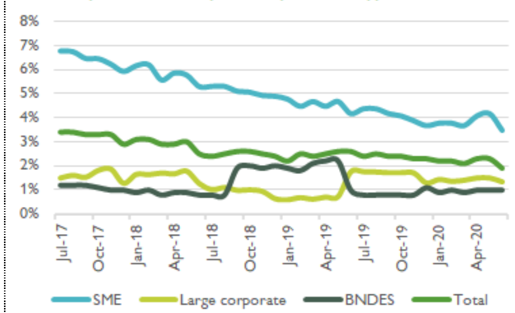
2.1. 90-day NPL ratio - by borrower type



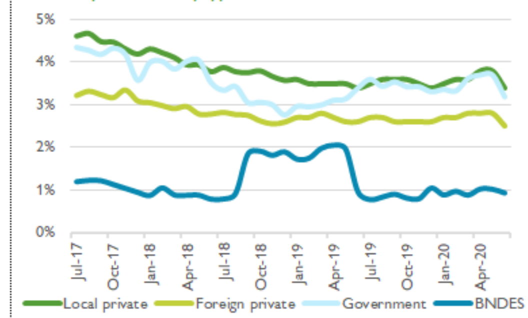
2.2. 90-day NPL ratio - individuals - by loan type



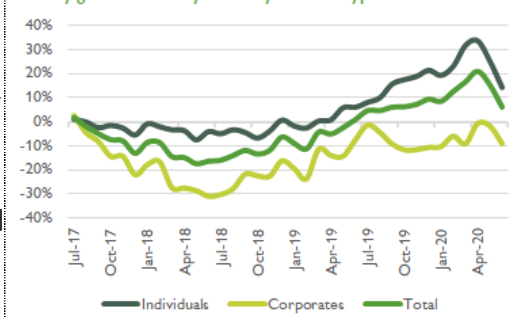
2.3. 90-day NPL ratio - companies - by borrower type



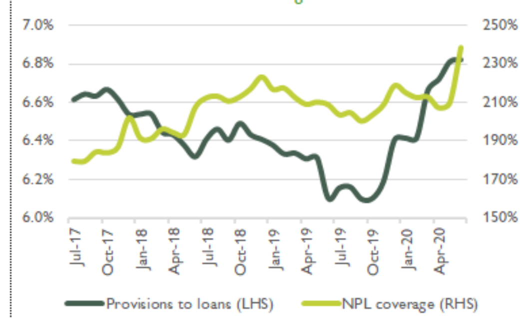
2.4. 90-day NPL ratio - by type of bank



2.5. Yoy growth for 90-day NPLs - by borrower type



2.6. Provisions to loans and NPL coverage



Source: Brazilian Central bank.

FRAME 3. Origination and rates of new loans: Rate pressure to continue

Cyclical trends: Origination stabilizes, but rates continue to decline

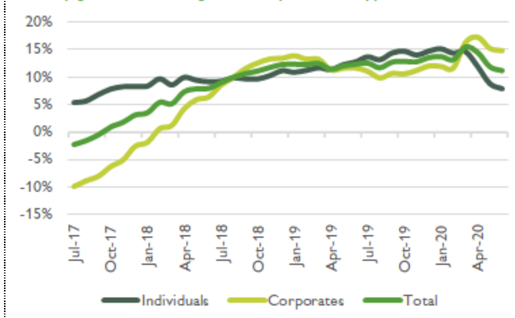
New loan origination was relatively unchanged mom after much movement (first up then down) reacting to COVID-19 in the last few months. This is a positive sign, as banks and borrowers may have found a more stable groove to operate. Demand continues to be lower in some lines, like auto, credit card and overdraft loans – but for other loans it has been surprisingly stable.

With the benchmark rate at unprecedented low territory, rates for loans continue their consistent march downwards. The decline is broad-based, across products (though hitting credit card and overdraft the most) and borrower-types. Given trends in competition, with the emergence of fintech alternatives, it is likely that this trend will continue.

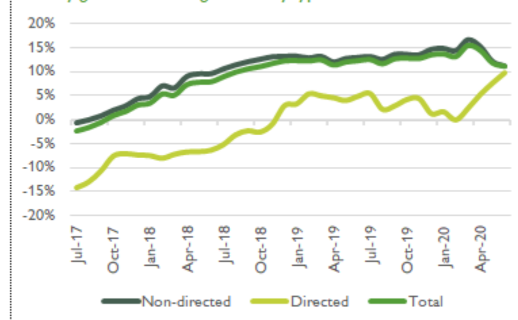
Structural forces: It's all about margins

It appears that COVID-19 driven asset quality pressure will not be as substantial a problem as originally expected, and as such the focus should be on how much pressure lower rates will apply on bank NIMs as the portfolio reprices. This pressure will likely be the main theme for bank results into the second half of 2020 and early 2021.

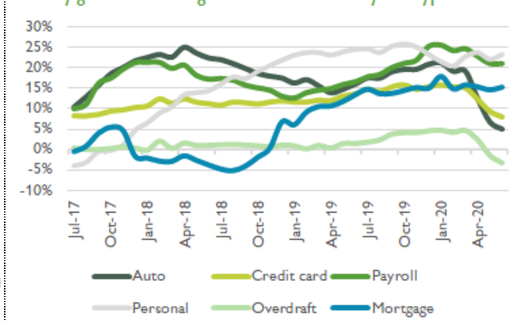
3.1. Yoy growth of LTM origination - by borrower type



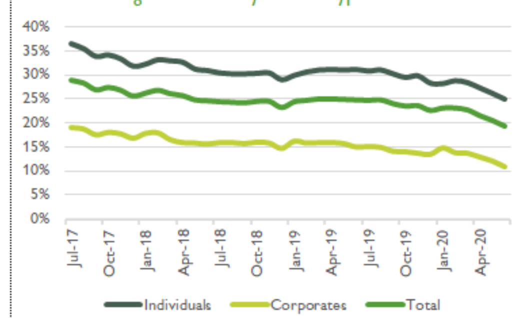
3.2. Yoy growth of LTM origination - by type of loan



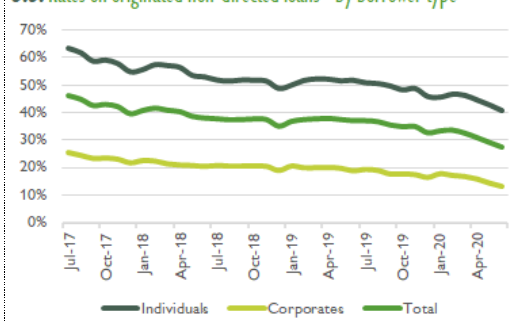
3.3. Yoy growth of LTM origination - individuals - by loan type



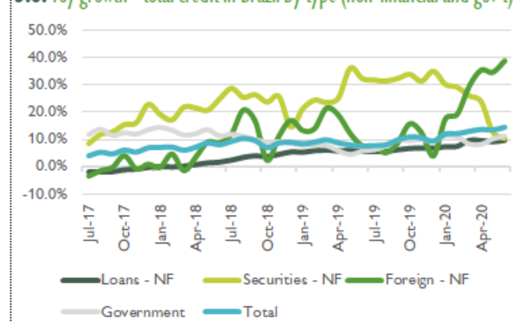
3.4. Rates on originated loans - by borrower type



3.5. Rates on originated non-directed loans - by borrower type



3.6. Yoy growth - total credit in Brazil by type (non-financial and gov't)



Source: Brazilian Central bank.