Frame by Frame: Brazilian credit data for September 2020

The Brazilian Central bank releases private sector credit information monthly. For the month of September (released on October 26), loan growth once again accelerated, largely on the back of pandemic-related SME lending, while new loan origination remained weak. Another all-time best for asset quality was offset by another all-time low for lending rates. For 3Q bank results, this means improved loan growth, lower provisions and weaker margins – and likely better profitability.

The highlights were:

- Directed SME lending drives growth. Yoy growth in directed loans accelerated 190 bp qoq, driven by government loan programs to support SMEs. Otherwise, growth was driven by credit card spending and personal loans.
- New loan originations still weak. Outside of directed lending, new loan originations – a better indicator of medium-term trends in loan growth – were once again weak, with sequential declines in yoy growth for most categories.
- NPL ratios at another all-time low. The improvement was broad-based, and with banks not lowering provisions it led NPL coverage to reach all-time best, meaning banks should be well protected when asset quality normalizes.
- Rates pressure continues. Rates on newly originated loans are at all-time lows across the board, which should mean pressure to bank margins once again. In the medium term, the low-NPL/low-rate tradeoff does not favor banks, as NPLs tend to normalize faster than rates.

	Value	Growth		
September 2020	(R$ bn)	Yoy	Δ mom	Δ qoq
Loans/credit				
Total non-financial sector	11,437	13.9%	+81 bp	-55 bp
Total non-financial private sector	6,545	17.0%	+91 bp	+20 bp
Financial system loans	**3,809**	**13.1%**	**+94 bp**	**+336 bp**
Non-directed	2,220	16.6%	+17 bp	+153 bp
Non-directed individuals	1,153	8.7%	+44 bp	-3 bp
Non-directed companies	1,067	26.5%	-32 bp	+362 bp
Directed	1,590	8.6%	+185 bp	+553 bp
Asset quality and coverage				
90-day NPL ratio	**2.4%**		**-20 bp**	**+240 bp**
Non-directed	3.1%		-16 bp	-56 bp
Non-directed individuals	4.6%		-20 bp	-60 bp
Non-directed companies	1.5%		-10 bp	-50 bp
Directed	1.4%		-27 bp	-27 bp
Provisions to loans	6.6%		-11 bp	-24 bp
90-day NPL coverage ratio	269%		+1,434 bp	+3,131 bp
LTM new loan originations				
Total	4,090	8.5%	-111 bp	-257 bp
Non-directed	3,656	6.2%	-179 bp	-494 bp
Non-directed individuals	1,850	1.4%	-168 bp	-560 bp
Non-directed companies	1,807	11.8%	-192 bp	-416 bp
Directed	433	32.3%	+614 bp	+2,232 bp
Rates on newly originated loans				
Overall	**18.1%**		**-50 bp**	**-90 bp**
Non-directed	25.2%		-91 bp	-173 bp
Non-directed individuals	38.0%		-100 bp	-170 bp
Non-directed companies	11.4%		-70 bp	-160 bp
Directed	4.9%		-36 bp	-40 bp
Penetration				
Debt service ratio (DSR) as of Jul-20	20.6%		-10 bp	-20 bp
Loans to GDP	52.0%		+100 bp	+210 bp

Source: Brazilian Central bank.

Carlos G Macedo
Cortex Consultoria
carlosgmacedo@cortexconsultoria.com

FRAME 1. Loan growth: Directed lending leads recovery

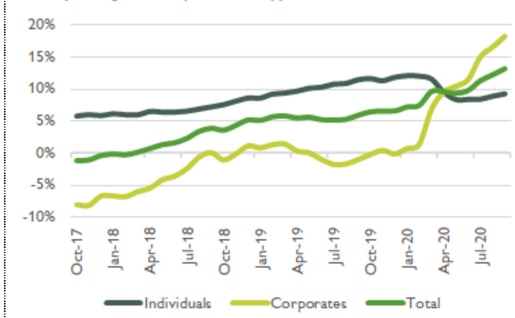
Cyclical trends: Directed loans driving

- Yoy growth in directed loans accelerated 190 bp mom, driven largely by loans to companies, which the Central bank attributes to loans to SMEs as part of the pandemic relief program.
- SME loans expanded 28.1% yoy (+860 bp mom), reaching the highest level in the database going back to January 2013 (also the third straight month of >5% mom growth). Yoy growth in loans to large corporates slowed 620 bp mom, losing the 30% level for the first time since April.
- In loans to individuals, yoy growth accelerated 40 bp mom on the back of personal loans (+60 bp mom) and stronger installment purchases in credit cards, while growth for other categories was mostly unchanged.

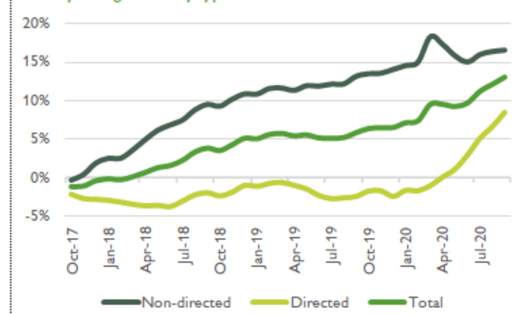
Structural trends: Managed growth

- Loan growth is resuming, though the means by which it is resuming is not ideal. It is being driven by loans to SMEs, which is good for economic activity, but largely on the back of directed lending, which has proven to be unsustainable in the past. The ultimate effect of this effort remains to be seen.

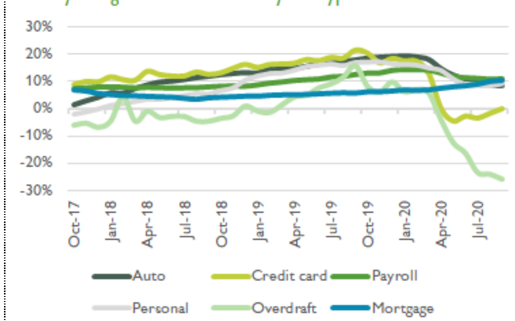
1.1. Yoy loan growth - by borrower type



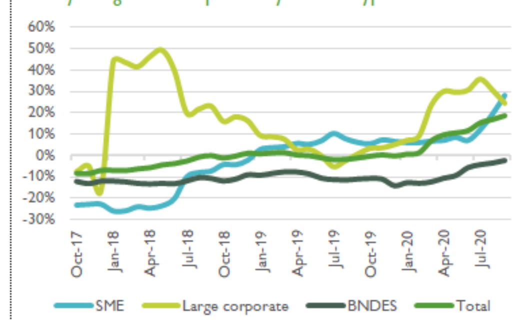
1.2. Yoy loan growth - by type of loan



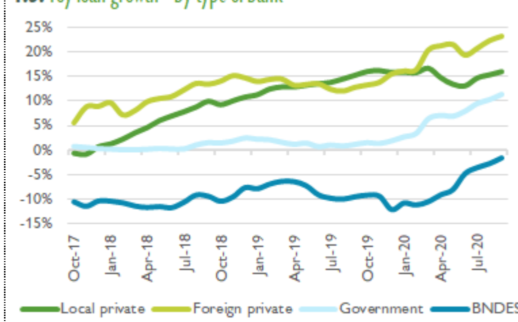
1.3. Yoy loan growth - individuals - by loan type



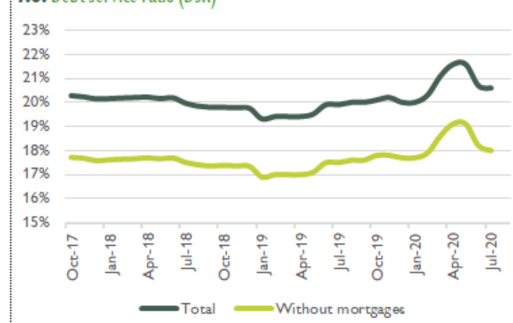
1.4. Yoy loan growth - companies - by borrower type



1.5. Yoy loan growth - by type of bank



1.6. Debt service ratio (DSR)



Source: Brazilian Central bank.

FRAME 2. Asset quality: The limbo dance continues

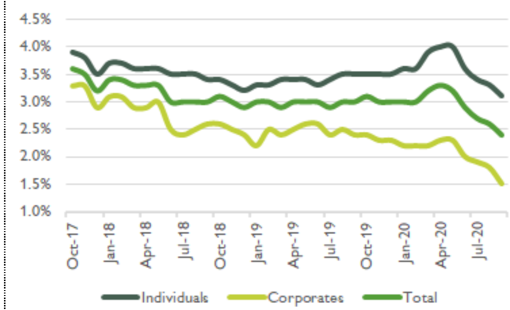
Cyclical trends: How low can you go?

- At 2.4%, the 90-day NPL ratio hit another all-time low, as did the ratio for non-directed loans at 3.1%. The ratio is at least at a 7-yr low for personal loans, mortgages and SME loans, but not for any other categories, indicating there could still be further decline going forward.
- This is corroborated by the yoy change in 90-day NPLs, which is now contracting at 10.6%, with falling levels observed in most categories. With loan growth at worst stable in many categories, this should lead to lower NPL ratios through at least the end of 2020. Given the amount of loans that were renegotiated and the magnitude of the aid to the SME segment, it is possible that this strength in quality lasts longer.

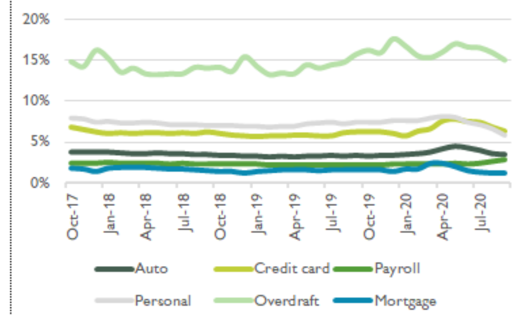
Structural forces: Normalization will come

- As solid as asset quality appears to be currently, it is being sustained by a one-time renegotiation effort (a panacea of sorts for consumer lending) and significant support from government programs (particularly in the SME segment). Both will eventually run out, and asset quality should normalize to levels closer to those seen in the last two years (NPL ratio of around 3%).

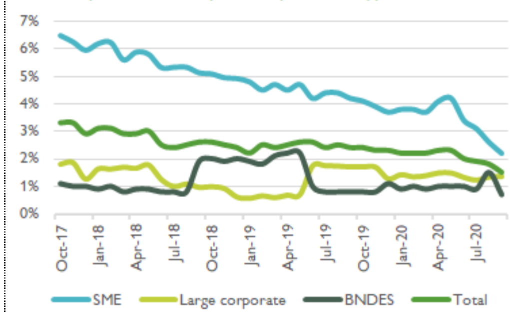
2.1. 90-day NPL ratio - by borrower type



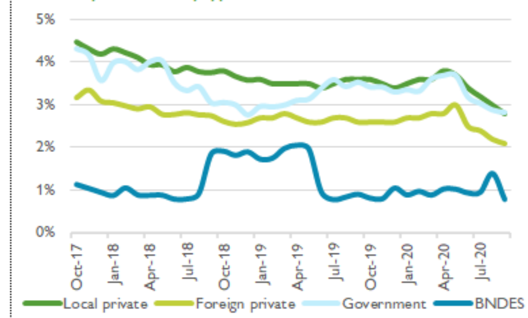
2.2. 90-day NPL ratio - individuals - by loan type



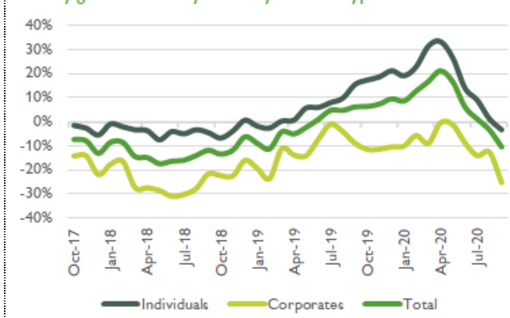
2.3. 90-day NPL ratio - companies - by borrower type



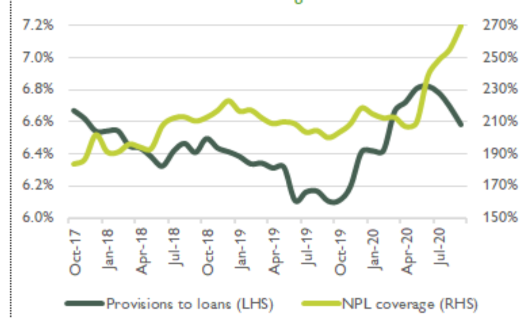
2.4. 90-day NPL ratio - by type of bank



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: Cyclical vs. structural trends

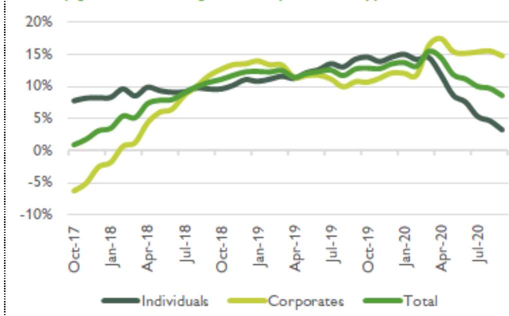
Cyclical trends: Originations still weak

- Once again, soft trends in new loans originations go against stronger loan growth levels. This is especially true for non-directed loans, in particular to individuals –LTM new non-directed loans originated to individuals were up 1.4% yoy (-160 bp mom, lowest since 2017.
- Rates on new loans continue to decline (most categories are at an all-time low), indicating that the pressure on banks' margins should remain in place for several quarters (given the time delay in repricing of the book).
- Provisioning remained strong (NPL coverage reached an all-time high of 270%), with banks not taking down the protections they put in early in the pandemic despite the sharp decline in NPLs. This is good protection: if NPL ratios normalized to 2019 levels, NPL coverage would still be at 220% - higher than 12 months ago.

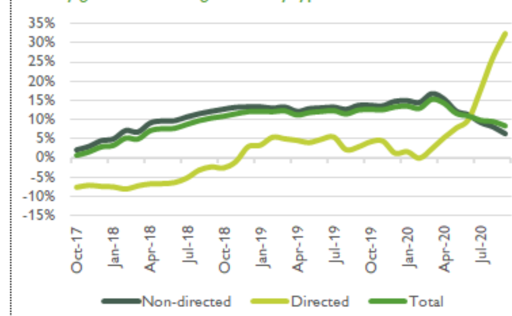
Structural forces: NIM a bigger concern than asset quality

- The tradeoff between low rates and strong asset quality is a poor one for the banks, because normalization will be faster for the latter, putting pressure on results.

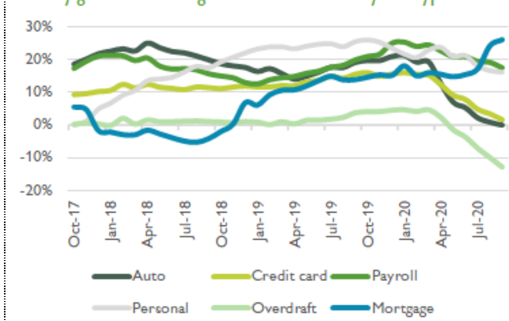
3.1. Yoy growth of LTM origination - by borrower type



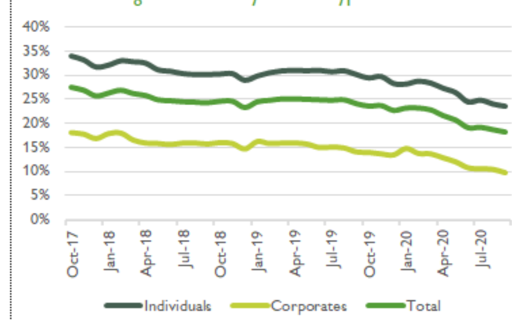
3.2. Yoy growth of LTM origination - by type of loan



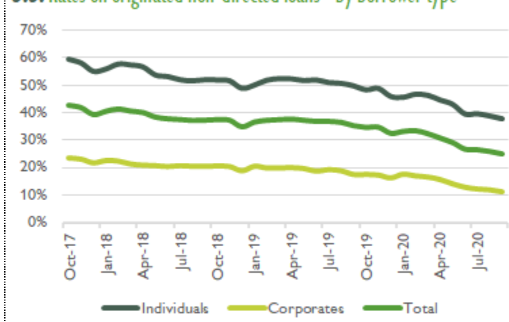
3.3. Yoy growth of LTM origination - individuals - by loan type



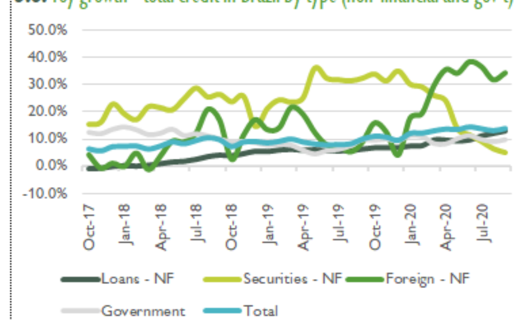
3.4. Rates on originated loans - by borrower type



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.