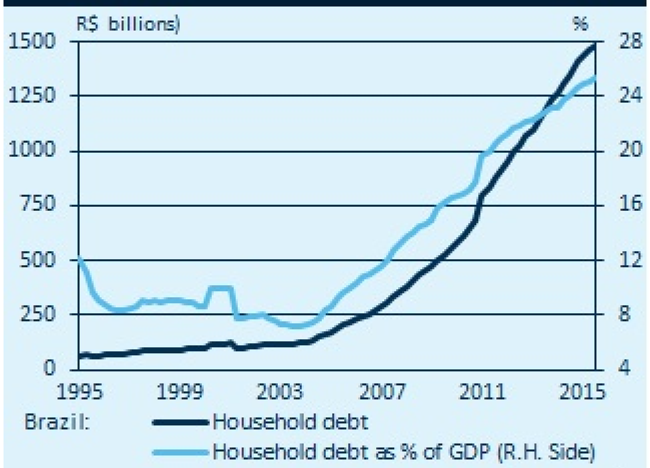
Same region, different household

Rising household debt can be driven by a range of factors. For example, Rajan (2010) proposed that rising inequality in the US created pressure for easier access to credit for low income households, which contributed to a housing bubble and subsequent crash. More generally, a sustained period of strong growth can cause financial imbalances to develop as households become overly optimistic on the economic outlook and banks loosen their credit standards. **Brazil has arguably seen both of these effects support a large increase in indebtedness in recent years.** Total economy-wide debt reached 146% of GDP in 2015, with households accounting for a material portion of this. Indeed, household debt has increased rapidly during the last decade, reaching the 25% of GDP last year, the highest in 20 years. This represents 46% of disposable income and monthly debt servicing alone accounts for 22% of net income. This ‘credit boom’ was supported by strong capital inflows, while robust growth boosted demand for credit among the growing middle class (see Chart 10).

The recent shift into recession has caused a painful reassessment of this debt position; unemployment is rising, wages growth is slowing, and high interest rates are intensifying borrowing costs. This has been made more difficult to manage by policy changes implemented by the government in 2003, aimed at reducing default risks faced by banks. ‘Pay-day’ or ‘payroll-loans’, which represent 70% of unsecured household credit, are deducted automatically from payrolls each month. President Dilma Rousseff increased the limit of what workers can borrow in pay-day loans last year to 35% of their monthly income from a 30% threshold, with the maximum maturity of the loans extended to 72 months from 60. These loans come with an eye-watering average interest rate of 27% at present. This squeeze on purchasing power is exacerbating an already weak economic environment. Indeed, the high stock of household debt and elevated servicing costs virtually eliminates the possibility of a consumption-driven recovery.

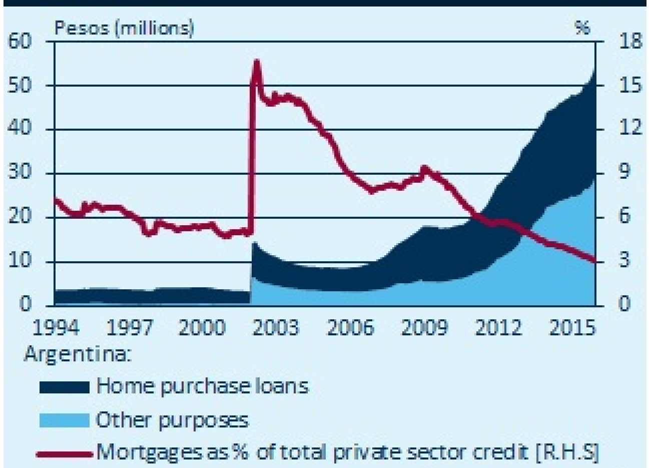
The Brazilian case is in stark contrast to the situation in Argentina. The latter has an economy-wide debt ratio of 62% of GDP, which has been declining from a peak of 199% following a default in 2002. This deleveraging has taken place mostly on the government balance sheet and household debt has actually increased, albeit from a very low base. Low levels of household debt are perhaps not surprising given the financial turmoil over recent years. Argentina remains plagued by high inflation, a low deposit base and very limited access to international funding. These factors hurt the development of the financial system and curtail access to housing credit. Housing credit is also dampened by the fact that real estate is seen as one of the only ways to preserve purchasing power in inflation-ridden Argentina. It is common for property prices to be denominated in US dollars, which further harms affordability and prevents a large swathe of the population from purchasing property (see Chart 11). **Argentinian President Mauricio Macri´s effort to regain access to international markets can help support housing credit, but only a solution to the inflation problem can revitalise credit dynamics in the country.**

Chart 10: Struggling households



Source: BIS, Standard Life Investments (as of Q3 2015)

Chart 11: Housing credit suffered the most



Source: BCRA (as of December 2015)