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# Brazil's New Middle Class Goes on a Spree

As the economy booms, shantytown residents buy on installment and pile on the debt. The government is worried about the prospect of defaults

By Harry Maurer and Alexander Ragir

Francisca de Carvalho lives in Rocinha, a shantytown that climbs a hillside just beyond the fancy Rio de Janeiro neighborhood of Leblon. Her fourth-floor apartment isn't what you'd expect in a *favela*: It's spic-and-span, with modern furnishings and a sweeping view. Carvalho, 54, recently spent about $400 to remodel her bathroom. She borrowed the money on her Banco Itaú credit card and pays 14 percent interest—per month. "I like nice things," she says.

More and more Brazilians are developing a taste for nice things and borrowing to pay for them. The world's seventh-largest economy expanded by 7.5 percent last year, and the Finance Ministry predicts growth of 4.5 percent this year, energized by demand for the goodies of the good life. Consumer debt is growing so fast that President Dilma Rousseff's government, in an attempt to deflate a possible credit bubble, has boosted the taxes that consumers pay on loans. The central bank has raised rates to discourage spending.

Brazilian stores encourage shoppers to buy on the installment plan. In Rio's Copacabana beachfront barrio, the Casas Bahia and Ponto Frio emporia trumpet stoves and washing machines for "10 Payments Without Interest." Down the street, you can make four payments to buy sneakers at Ultraflex.

Under such an arrangement, a store would appear to be assuming all the risk—and with inflation running at 6.5 percent, losing money to boot. In fact, the sticker price already has a steep interest rate built in, so large chains are making money more as consumer-finance houses than as retailers. Their profits reflect the boom: Lojas Americanas, Brazil's biggest publicly traded discount retailer, saw earnings jump 33 percent in the first quarter from a year ago, and at Hering, a clothing chain, quarterly profits rose 74 percent. Shoppers who can afford to pay upfront can often bargain the price down or find the same item online for less.

During President Luis Inácio Lula da Silva's eight years in power, from 2003-2011, 24.5 million people officially escaped poverty, and 35.5 million moved into the lowest rung of the middle class, the so-called Class C, earning $1,100 to $3,900 a month, according to researchers at the Getulio Vargas Foundation university. For these strivers, credit abounds for the first time. Total consumer loans rose sixfold over the past eight years, to $495 billion, and jumped from 24 percent of gross domestic product in 2003 to 46 percent today, according to the central bank. About a fifth of these loans are paid by automatic deduction from paychecks. Since 2004, bank credit cards have tripled, to 159.5 million, and retailer cards have nearly quadrupled, to 233.5 million. The average interest rate on credit cards is 238 percent annually, while loans from retailers cost 85 percent, and personal loans from banks 47 percent.

Because of stiff Brazilian tariffs that shield the domestic market, items can cost far more than they do, say, in the U.S. The cheapest model of an LG Electronics 32-inch flat-screen TV goes for $749 at Casas Bahia, vs. $449 at a P.C. Richard & Son electronics store in New York.

Borrowers often don't know what they're getting into. "These are people with no experience of credit," says Andrew Frank Storfer, president of Anefac, a São Paulo association of finance and accounting executives. "There's no culture of managing debt."

Maria de Matos can testify to that. A neighbor of Carvalho's in Rocinha, Matos got her first credit card five years ago and began frequenting the Barra da Tijuca shopping mall. Every month she took a bus there with the money she earned cleaning houses to make minimum payments, to do some shopping. At age 48 and illiterate, Matos says she had no idea what rates the stores were charging. A year ago she declared bankruptcy on her $1,100 debt. "It was like I was swimming but just sinking deeper and deeper," she says.

While the central bank regulates how much banks must set aside to cover risky loans, the banks can lend at whatever rates and terms they want. Partly as a result, Brazilian banks enjoy an average profit margin of 15 percent, compared with 7.8 percent for U.S. lenders, according to Bloomberg data. Brazil also lacks consumer credit bureaus, which means there's no way for consumers to earn cheaper loans with a good credit score, because the government only tracks borrowers who have defaulted.

So far, with the economy roaring and labor markets tight, consumer delinquency rates haven't risen dangerously. Itaú Unibanco Holding, the nation's biggest bank by market value, just beefed up provisions for bad loans, saying it expected defaults to rise. Lula boosted bank reserve and capital requirements in December, while Rousseff nearly tripled, to 6.6 percent, a tax Brazilians pay on any credit-card purchases made abroad.

Although more credit-throttling moves are expected, it may be tough to keep Brazilians at home now that they've tasted the pleasures of mall-crawling. "Shopping was such a temptation," says Matos of her life before bankruptcy. "Now I regret it so much. It dirtied my name."

***The bottom line:*** *Brazil's newly prosperous consumers may endanger the country's economy by borrowing at sky-high rates.*

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