Is Brazil's consumer-spending boom a bubble?

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RIO DE JANEIRO: Brazil's consumers seem close to maxing out on their credit-fueled spending on everything from new cars to beauty treatments that has been a crucial growth engine for Latin America's largest economy.

The main question now is: How hard will they fall?

Most see a gentle easing of demand as consumers have their wings clipped by the central bank's five interest rate hikes so far this year — including Wednesday's rise that brought the benchmark rate to 12.5 percent — and government steps to curb credit that has been growing at an annual pace of around 20 percent.

But there is a risk of a bumpier and steeper ride down — and a small, but growing, group of economists are pruning expectations for growth on concern that bubble-like conditions in the credit and job market could pop.

"The current pattern of growth in Brazil is looking particularly unsustainable," said David Rees, Latin America economist at London-based Capital Economics.

His firm has penciled in a meager 2.5 percent expansion for Brazil in 2013, believing that consumers have binged too much on credit. That is a shockingly low figure for a country that has become used to being ranked alongside China and India as the world's hottest big emerging markets.

Brazilians have splashed out cash and credit cards as they rushed up the social ladder into a middle and upper income class that has swollen by 48 million people since 2003 — more than the population of Spain.

Their unbowed desire for more cars, TVs and beauty treatments kept the economy out of recession in 2009 after the global financial crisis and propelled gravity-defying growth of 7.5 percent last year. Brazil's economy is heavily geared toward consumption — household spending accounts for about 60 percent of gross domestic product compared with around 36 percent in China.

Now, though, the headwinds appear tough to resist as stubborn inflation, painfully high interest rates and a heavy personal debt burden threaten consumers' spending power.

To be sure, a robust job market is pushing up wages and supporting consumers' still brisk spending. Unemployment is near historic lows at 6.2 percent and salary gains have been handsomely outstripping inflation.

But jobs are traditionally a lagging indicator of activity and will be the last to feel the cooling of growth to around 4 percent this year, economists say.

"If you take away a strong labor market and you take away credit you basically get a different Brazil, a much lower growth Brazil," said Tony Volpon, Latin America strategist at Nomura in New York.

For him, Brazil is on course to return to more "boring" rates of growth — just 3.8 percent this year and 3.7 percent in 2012 — barring deeper reforms to improve Brazil's business environment.

Volpon believes the job market may have entered bubble territory as companies chase scarce workers with higher salaries despite a gathering slowdown.

"Labor productivity is basically crashing in Brazil. Unless companies stop paying these crazy salaries ... they are going to destroy their profitability," he said.

Weaker consumption would leave Brazil with few bright spots other than strong foreign demand for its mining and farm commodities. The Brazilian currency's surge to around 12-year highs against the dollar has opened up a world of cheap imports and bargain foreign travel and left domestic industry hurting.

Thanks to interest rates on consumer debt that average more than 45 percent a year, debt payments suck up a quarter of Brazilians' income, compared with a peak in the United States of less than a fifth before the 2008 financial crisis. Whether this represents a credit bubble has been the subject of a lively debate among analysts, but there is a growing consensus that consumers are coming to the end of their tether.

Consumer confidence fell to a two-year low in June, according to a national industry index, and defaults on personal loans rose 22 percent in the first six months of the year, the biggest jump in nine years.

"You could argue that if the job market deteriorates a little bit those non-performing loans are going to go through the roof," said Rees.

Overall credit in the economy has more than doubled to 47 percent of gross domestic product since 2003, still low compared to rich economies, but higher when the near-extortionate interest rates are considered.

Stories of consumers up to their necks in debt have become standard fare in the country's media. The Globo news website this week published a series of portraits of indebted Brazilians, including a 27-year-old journalist who ends each month with a 600 reais ($387) overdraft to pay for beauty treatments and a retiree in Rio de Janeiro who spends a third of his income paying back his 20,000 reais in debt.

"The rope is around my neck," the retiree, Valdemar Bianco, was quoted as saying. "I have to find a way out of this."

Despite such anecdotes, there are few signs that a slowdown is under way. Automobile sales rose 10 percent to a record high in the first half of the year and demand for domestic flights jumped 19.5 percent in the year to June.

"There has been resilience to these contractionary measures. This new middle class is more sustainable than I thought and than most analysts think," said Marcelo Neri, an economics professor at Rio's Getulio Vargas Foundation who tracks social changes in Brazil.

Gustavo Rangel, chief Brazil economist at ING Financial markets in New York, agrees that consumers could yet confound the pessimists. He expects a slight rebound in growth to 4.2 percent next year.

"I totally disagree with people who say Brazil has a credit bubble," he said. "Although we should see some slowing down because of credit, it may not be extraordinary. Consumption should continue to lead growth."

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