High Interest Rates and Fintech Solution in Brazil

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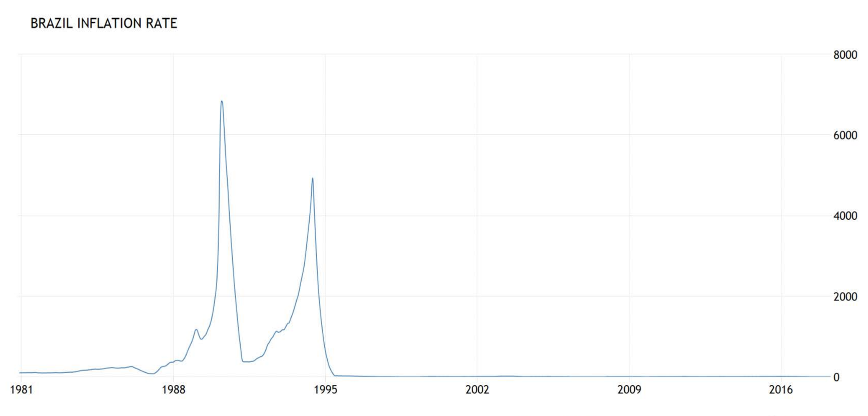
INTRODUCTION

History

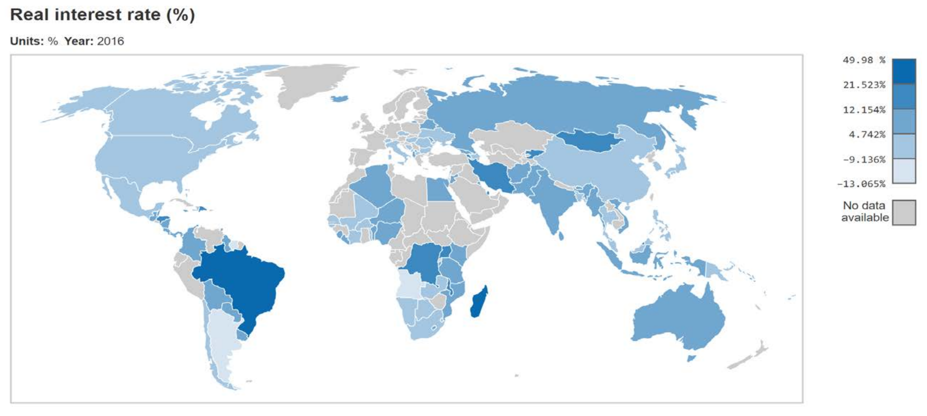
Since the implementation of Import Substitution Industrialization (ISI), Brazilian economy had experienced a period of rapid economic growth, leading the “Brazilian Miracle” in 1970s. As the country underwent serval large-scale trade liberations and privatizations, with increasing investment and development projects came an oversized government budget, which was then financed with extensive external debts and a loose monetary policy. As a result, **hyperinflation** set in: inflation peaked at 2950 percent in 1990. Four years later, with the launch of Plano Real, Brazilian macroeconomic environment was finally stabilized, GDP per capita rising again as Brazil started to benefit from the commodity boom. However, this episode of a fourteen-year period three-to-four-digit annual inflation did forebode the peculiarities of Brazilian banking regulations in later years, namely its **exorbitant interest rate and an expensive credit market**.

“We believe the relatively fresh memory of extraordinarily high inflation rates still has a profound impact on economic behavior in Brazil. In particular, we believe there is a tendency in Brazil to overestimate medium-term inflation risk. As a result, the central bank has to be particularly vigilant in order to keep inflation expectations contained.” (Brazilian Bubble, “Analysis: Here is why interest rates in Brazil are so high…”)



Issue

“Brazil's high real interest rates have often been cited as one of the most important constraints to economic development. Some authors have even referred to this problem as the most binding constraint to growth.” (IMF, “The Puzzle of Brazil's High Interest Rates”)



With **the fourth-highest interest burden in the world** (over 40% real interest rate), Brazil pays approximately 7.6 percent of its GDP into interest payment on public debt. On an individual level, 40 million Brazilians are paying over 230% APR on unsecured loans such as credit cards, overdraft and personal loans.

IMPACTS AND REASONS

Impacts

Such **high interest rates prohibit the use of leverage and discourage investments**, stifling any economic stimulus. Despite the **burden on economic growth**, it is in the interest of large banks to maintain a high Selic rate, as over 64% of Brazilian government bonds are tied to this policy rate, whose guaranteed returns generate enormous profitability for the financial sector.

“For the years 2003–2015, the profits of the four biggest banks rose by 460 percent — from 5 billion reais to more than 28 billion reais” (CEPR, “Brazil's Exorbitantly High Interest Rates Remain a Drag on Economic Growth, Report Shows”)

Reasons

Aside from a **history of hyperinflation** and the Central Bank's vigilance against it, other driving forces pushing up Brazilian market interest rates include low domestic savings and credit market segmentation (high share of subsidized lending).

According to classical “Income Theory”, equality of savings and investments is brought by the interest rate: when investment needs exceed the supply of national savings, there is an upward pressure on interest rates to encourage savings and curb consumption demands, restoring equilibrium and avoid overheating. This is exactly the case in Brazil. At around 20% GDP, **Brazil's national savings rate is among the lowest in world**, compared to most advanced and emerging economies, and therefore the market interest rates soar.

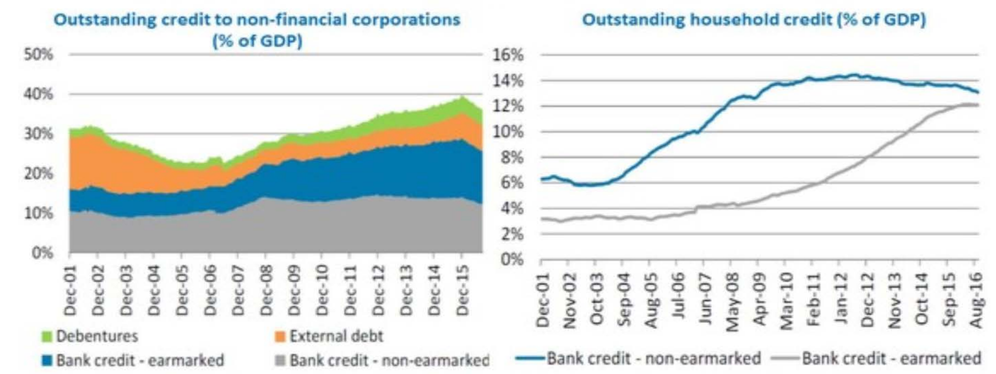
Gross national saving (% of GPD) 2017 Country Ranks, By Rank

https://photius.com/rankings/2017/economy/gross_national_saving_2017_0.html

SOURCE: CIA World Factbook 2017

Rank	Country	Value	Date of Info
1	Suriname	57% of GDP	2016
2	Singapore	46% of GDP	2016
2	China	46% of GDP	2016
3	Brunei	44.2% of GDP	2015
4	Qatar	42.3% of GDP	2016
5	Panama	41.7% of GDP	2016
…			
86	Brazil	17.2% of GDP	2016
87	Uruguay	17.1% of GDP	2016
88	Uganda	16.9% of GDP	2016
89	Namibia	16.8% of GDP	2016
90	Paraguay	16.5% of GDP	2016
91	Benin	16.3% of GDP	2016
91	South Africa	16.3% of GDP	2016

On top of that, **Brazilian credit market is segmented with a high share of subsidized lending** from government-backed financial institutions, such as development banks (BNDES). These earmarked credits are provided at a lower rate than the policy rate, and therefore the Central Bank, controlling only a fraction of the credit market, has to raise interest rate even further in order to keep credit demands in check with the inflation target.



FINTECH SOLUTION: CREDITAS

Brazilian Credit Market

To solve the puzzle of high interest rates in Brazil, local startups have proposed ingenious solutions. Among them, Creditas stands out. **Creditas is a niche fintech specializing in secured lending, offering credit at lowest consumer rates**. The company sees a potential in the expensive credit market: **Brazilians are paying the highest interest rates in the world**, while Brazil being the outlier having less debt but way higher interest rates compared to other countries. Moreover, most Brazilians rely on highly-priced unsecured loans, while their assets are largely debt-free, and the **nation as whole is significantly underleveraged.**

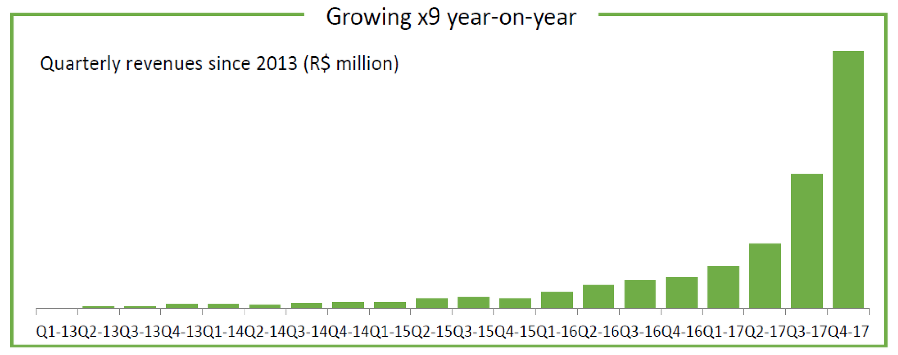
Lobby of Creditas.

Online Platform For Secured Lending

To seize the market, **Creditas has launched the only digital platform for secured loans in Brazil, providing credit against collaterals at 19% and 15%** (home and auto) as opposed to a market rate well over 200%. The efficiency of online services ensure a low cost which is then passed back to consumers in the form of **zero upfront charges**, which serves as yet another incentive for people to opt for Creditas instead of traditional loans.

Competitive Advantages

As a lending platform, Creditas **collaborates with incumbent banks to provide loan services**, while **slashing costs** by upgrading their technologies. With sophisticated backend programs, the process of credit analysis, collateral valuing, and legal analysis are largely streamlined, turning the company into a “a factory of human resources” (Fabio Zevibil, VP of Bus Dev). By focusing on a **niche market**, Creditas avoids direct competition, and by **automating all processes**, it attains **efficiency**, sustaining its competitive advantages. All things combined, **it has been growing at 9 times year on year**, and the projected growth reaches another 3 to 4 times for the next three years.



A Slide from Creditas's company presentation

PERSONAL TAKEAWAYS

Change of Topic

The most interesting part of the project for me is to see how expectations prior to the trip were verified and challenged, raising new questions and gaining new perspectives.

While conducting the preliminary research, I was impressed by how burgeoning Brazilian Fintech sector is, how much growth and revenue it has achieved and is projected into the future. However, my original topic of Fintech ecosystem was changed during the trip. While visiting companies and universities on-site, a recurring issue drew my attention: almost all companies and university lectures mentioned how peculiarly high the interest rates are in Brazil, and I could not help but wonder why and whether there is a remedy, and hence the new topic. Instead of corroborating my prior research with evidence found on the trip, setting out on a new journey is both stimulating and educational from a hindsight.

Lesson Learned

This experience abroad is a tremendous help for me to grow as a personal and professional. Not only did I have the immediate access to first-hand information, which largely framed my understanding of the topics, but I was also able to see issues in different lenses, piecing all information into a more wholistic picture.

Group photo at the airport

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