

NPL in Brazil: the next (emerging) hot market!

#2.2018

AUTUMN UPDATE
PREPARED BY PRIME YIELD

Non-Performing Loans (NPL) in Brazil are an increasingly attractive market for international investors, that are now paying closer attention to emerging countries that offer higher returns. And at the same time, Banks in Brazil are now more open to sell NPL portfolios, recognizing that this is a crucial strategy to deleverage and improve the national financial system performance. Demand and supply are lining up and Economy, even if not expanding rapidly, is recovering, thus opening very robust prospects for NPL transactions over the next two years in Brazil.

Economy

Following two years of economic recession, Brazil returned to GDP growth in 2017 (+1,0%) and Economy is expected to further accelerate during 2018, although not at the pace initially estimated. The latest forecasts by Brazilian Central Bank Banco Central do Brasil have slightly revise downwards GPD growth from 1.49% to 1.47% for 2018, but maintained expectations for 2019 in +2.5%. As for Q1 2018, Economic performance was above market expectations, with a GDP growth of 1.2%, but it is to note that this increase still means a slowdown from the 2.1% figure recorded in the previous quarter. As for Q2, recent data released by the National Statistics Office IBGE, show that Brazilian GPD grew 1% y-o-y, confirming that Economic activity continues to be moderated and recovery should be slower than initially forecasted. In addition, the Presidential elections scheduled for October are expected to impact the pace of Economic recovery.

GDP GROWTH 2017

1.0%

GDP GROWTH FORECASTS 2018

1.5%

Property Market

The property market continues to reflect the performance of Economy, having accentuated the recovery path during 2017 and 2018 confirming the positive trend, but at a moderated tone, especially in the residential sector. Overall, the housing market proves to be progressing towards a more balanced activity between sales, new launches and the already built stock. In Q2 2018 (CBIB, the Brazilian Chamber for the Construction Industry) housing sales in Brazil totaled 29,951 units, a y-o-y growth of 32%. This follows a 9.4% increase in sales (to about 94,000 units) at the end of 2017 and further accelerates the 22.3% growth recorded in Q1. New launches have grown in Q2 (+19.9% to 25,485 units, and contrary to the -14.8% fall in Q1 and -12.3% in 2017), but remain below sales, at a time when final supply further decreased 23% vis-à-vis Q1 2017 (to 124,715 units) and the average take up time also backed from 19 months one year ago to 12 months in Q2.

As for housing prices, recovery signs are not so positive. After 2017 ended with a slight decrease in prices (according to FIPEZAP) of 0.6% (annual variation rate), 2018 confirmed this trend and, since January, decreases sit around 0.6% and 0.7% (-0.6% in May). Since 2016, annual variation of residential prices has been very residual, ranging from maximum -1% falls and +1% increases, reflecting a low volatility.

GROWTH OF HOUSING PRICES
(MAY 2018 YoY)

-0.6%

HOUSING SALES (Q2 2018)

29,951

NEW HOUSING LAUNCHES (Q2 2018)

25,485

NPL Stock and Ratio

Impacted by the deepest economic recession ever in Brazil (2015/2016) and by a recovery that seems to be weaker than initially forecasted, the amount of Non-Performing Loans (NPL) in the country is estimated to currently sit at around R\$ 550/650 bn, although there isn't an official figure. As for the ratio of NPL (to total gross loan, in %), Q1 recorded a 3.51% ratio, less than the 3.59% observed in the previous quarter and confirming the downward trend since the 4.01% (quarterly data) peak in Q3 2016. More recent figures referring to the breakdown by segment, show that NPL ratios both in companies and households are now (in June) lower than the levels recorded in December, declining from 3.54% to 3.49% in households; and from 2.91% to 2.55% in companies. Nevertheless, this direct comparison of monthly ratios hides another trend, also verified in both segments. Although ending the first half of the year below 2017, both the ratios did not have a regular downward path over 2018. In companies, NPL ratio was up to 3.06% in January and again to 3.10% in February, and a steady decrease was felt only in June (0.4 percentage points). In the household segment, January was also a month of increase (to 3.72%), but since then the trend was of consistent decline month on month.

Potential NPL Deals

2018 could be an exceptional year for NPL sales in Brazil, since both demand and supply are lining up to be more active, in a market that presents a huge potential. NPL stock in Brazil has a very large dimension (even in a worldwide context) given two years of deep economic depression and the market (considering both investors in NPL acquisitions and servicing companies) is now getting more professionalized.

In what regards demand, Brazil can benefit from the increasing attention of international investors, that are currently targeting more emerging markets as an alternative to European NPL trading. In addition, several specialized servicing companies have already announced their intention to be active buyers of NPL portfolios in Brazil. As for sellers, Banks operating in Brazil are now recognizing that NPL sales are a crucial part of the recovery strategy for the national financial system. In fact, some of the largest national banks such as Bradesco or Itaú are placing several NPL portfolios in the market for disposal or plan to do so. Santander alone is expected to dispose R\$ 2bn in NPL during the second half of 2018. And at the same time, the quality of portfolios is now increasingly interesting for investors, given that the sale of NPL is covering more and more company portfolios (before NPL sales were mostly concentrated in household segment) and this is seen by investors as an evolution in the market. So, if 2017 is estimated to have recorded R\$ 30-40 bn NPL trades (almost doubling the previous annual average of R\$ 20-25 bn), 2018 could accelerate that amount in some 20% (to some R\$ 36-50 bn) although the pace of economic recovery will be very important to the sale of NPL over the next two years. A stronger Economy will boost the confidence of investors in having highest volumes of bad debt recovery, thus achieving higher returns.

About Prime Yield Brazil | NPL&REO Services

Established in 2010 (Brazil), Prime Yield delivers valuation, research and advisory/consultancy services and has been focusing on the NPL&REO market, specializing in Portugal and Brazil. Thinking about the players (buy and sell) who want to be actively involved in the transaction of this type of assets, the company created the new business area NPL&REO Services, also supported by Prime AVM&Analytics, an advanced technological solution that allows NPL's investors and sellers to have property valuations in a fast, simple and reliable way both for single assets or entire portfolios (RESI or CRE). Prime Yield is regulated by RICS and REV-TEGoVA, also being certified by CREA - Conselho Regional de Engenharia, Arquitetura e Agronomia under nr 0826831.

NPL STOCK

R\$550-650_{bn}

NPL RATIO TOTAL (Q1 2018)

3.2%

NPL RATIO HOUSEHOLDS (06.2018)

3.5%

NPL RATIO COMPANIES (06.2018)

2.9%

ESTIMATED NPL TRANSACTION VOLUMES (2018)

R\$36-50_{bn}

2018 NPL TRANSACTION Y-O-Y GROWTH

20.0%