Economic slowdown could be end of smooth ride for Brazil's Rousseff
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Brazilian President Dilma Rousseff has enjoyed a smooth ride since her inauguration in January 2011. Despite a series of corruption scandals that led to the resignation of seven of her cabinet members, she has suffered no real political damage after 18 months in office. But a flagging economy and a related crisis roiling small and medium-sized Brazilian banks could pose the greatest threat yet to her leadership.

Rousseff's Worker's Party isn't accustomed to operating under the politically corrosive effects of protracted economic troubles. Brazil's economy, Latin America's largest, has thrived under the party's stewardship, recovering quickly from the financial crisis that saw growth drop to negative 0.3 percent in 2009. In fact, since the 2002 inauguration of Rousseff's predecessor, President Luiz Inácio "Lula" da Silva, economic growth has averaged 4.1 percent annually.

That resilience may be tapering off. Analysts are projecting poor growth for 2012 -- close to last year's tepid 2.7 percent or even lower.

The government's main fear is a slowdown that leads to a sharp increase in unemployment. Joblessness is currently at a politically manageable 6 percent, but in a scenario of massive layoffs, the president's popularity "would greatly suffer," according to a recent Weekly Report by Brazil Intelligence, a political consultancy based in the capital, Brasília.

So far, Rousseff has kept Brazilians working, and she has been rewarded with a 77 percent approval rating, according to a March poll commissioned by the National Confederation of Industries.

"As long as people are employed, and they're receiving their salaries and are able to consume more, approval will stay high," said Cristiana Lôbo, a political commentator for Globo News TV.

To fend off unemployment, Rousseff's administration has dusted off the stimulus measures that helped Brazil weather the 2009 financial crisis, targeting labor-intensive sectors, such as car manufacturing and construction. Economy Minister Guido Mantega did his part to buck up business confidence by talking up the policies, which included a loosening of car loan regulations that will allow banks to lend an additional $9 billion.

"The sector that was growing the least . . . was the automotive sector, which weighs heavily in GDP," Mantega told reporters on June 6.

In fact, it seems every part of Brazil's state apparatus is doing what it can to put wind into the economy's sails. The Central Bank has cut interest rates repeatedly since late last year, bringing borrowing costs to historic lows. The state-controlled Banco do Brasil, Latin America's largest bank, has also pitched in with a promotion dubbed "Bom pra todos," or "Good for all," aimed at offering home, vehicle and consumer loans at slashed rates.

Unfortunately, this multidirectional stimulus may not suffice.

As they did during the financial crisis, Brazilian economic policymakers are relying heavily on increasing the availability of credit in the economy. But this time the crisis is more of a slow burn than a sudden conflagration.

"The government is full of good intentions, in the sense of wanting to encourage economic activity, but this is a battle it can't win," said Rodolfo Amstalden, an analyst with São Paulo-based equity research firm Empiricus. "The influence from abroad is too great."

However, even limited damage control is better than passivity, he added.

Other analysts see a risk that Brazil's government, desperate to buoy growth, is pushing a credit expansion at a time when households have already taken on too much debt and consumers are complaining about overly aggressive loan-peddling. Brazil’s leading consumer defense organization, Idec, and bank employee unions recently joined together for a campaign to curtail the sale of financial products that are “unnecessary and inappropriate to consumers’ profiles.”

Car and personal loans together make up the majority of the consumer credit market in Brazil, where mortgages are still relatively uncommon and interest rates are high.

But now Brazil’s consumers are starting to default in higher numbers, despite a modest debt load relative to the overall size of the economy. The percentage of nonperforming loans is rising, according to credit agencies and government data. For example, the percentage of car loans 90 days overdue neared 6 percent of the total in March, twice the rate of two years before, according to Central Bank data.

Central Bank President Alexandre Tombini told a Senate commission on June 12 that defaults are under control and that Brazil’s lower interest rates will allow stressed consumers to refinance.

Even so, the Central Bank has been repeatedly forced to put out fires at consumer-oriented small- and medium-sized banks. To compete with larger rivals during the credit boom, these banks began to engage in practices reminiscent of the U.S. subprime mortgage bubble, including “creative” accounting and the packaging of questionable loans into off-balance-sheet asset-backed securities.

On June 4, Banco Cruzeiro do Sul, a niche player specializing in paycheck-deductible lending worth roughly $3.4 billion, was taken over by regulators. The next day, authorities outlined serious accounting irregularities, including possibly fictitious loans, and estimated the hole in the bank’s books at $650 million.

In 2010, Banco Panamericano, a lender specializing in vehicle loans, collapsed after announcing an even larger shortfall.

No one fears a failure at the far larger Banco do Brasil or the equally well-capitalized major São Paulo-based private sector banks -- Banco Itaú, Banco Santander Brasil and Banco Bradesco -- that are wired into economies across Latin America and Europe.

Yet all of Brazil’s banks are seeing their margins eaten away by rising consumer defaults, and most are pulling back on lending.

That is why the government has drawn criticism for plowing more credit into the market, despite the evident dangers. These risks would be further exacerbated if unemployment were to rise, making consumers’ debt even more unmanageable.

The worst-case scenario is if the stimulus, geared to consumption and lending, leaves the economy more vulnerable to a sharp downturn and an unemployment spike. Were that to happen, Rousseff would pay a steep political price, one that might keep her from cruising to a second term.

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