

RETAIL: BRAZIL

RISK ASSESSMENT: MEDIUM

HIGHLIGHTS AND OUTLOOK

Since early 2017, the retail sector in Brazil has rebounded, after a severe economic crisis in 2015-2016. At that time, retail was hardly hit, shrinking in two years by an accumulated rate of 10.6%, due to a surge in the unemployment rate, inflation and interest rates. **Retail sales in volume terms climbed by 2% YoY in 2017 and a further improvement is expected in 2018.** The Brazilian retail sector has indeed reported positive yoy variations for the last 15 months up to June 2018. **In this half of the year, retail sales rose by an accumulated rate of 2.9% YoY.** The rebound in sales is driven by a series of factors, such as: a lifting of previously repressed consumption (due to the years of recession), a now controlled inflation rate (at 4.5% in 12 months cumulative until July 2018) and the considerable easing of the monetary cycle conducted by the central bank (the reference rate Selic is currently at 6.5% per annum, down from 14.25% until October 2016). The incipient recovery of the job market has also contributed to aforementioned trend. Seasonally adjusted unemployment reached a negative peak of 13.1% in April 2017 and has declined in order to stand now at 12.4%.

Retail sales should continue to grow in the upcoming months, though it should not generate enthusiasm. On the one hand, the gradual recovery of the job market, the moderated inflation levels and the continuity of the pass through of lower reference interest rates to the banking lending rates should contribute positively to the sector. On the other hand, a stronger impetus of activity should be undermined by political uncertainties related to the presidential elections of October 2018, the still high unemployment rate and the relatively high lending rates (despite some expected reduction in rates).

The e-commerce market has increased above the retail sector average in recent years and all the big retail players operate in in this market. According to a survey conducted by the Brazilian Electronic Commerce Association (ABCOmm), the sector grew by 12% in 2017, with a turnover of BRL 59.9 billion (USD 15 billion). By 2018, the forecast for evolution is even higher, 15%, and revenue should reach the mark of BRL 69 billion (USD 17.3 billion). Additionally, major companies in the sector have strongly invested in recent years in online marketplaces, a type of e-commerce site where the product is provided by multiple third parties. The great interest in this market can be explained by the fact that the inventory costs stay with the sellers and not with the Marketplace host. With an eye on this market, American Amazon launched its marketplace for electronics in Brazil in October 2017.

Strengths

- Large market with a population of over 200 million inhabitants
- Household consumption represents roughly 63% of GDP
- Consumption a key structural driver in the Brazilian economy

Weaknesses

- Unemployment rate still at a high level
- Recovery in job market has been underpinned by unregistered and self-employment workers
- High financing costs

Key Players

(by Turnover, 2017 figures)

- **Via Varejo:** controlled by the Pão de Açúcar group, which in turn is controlled by the French Casino
- **Lojas Americanas S.A.:** controlled by three major Brazilian entrepreneurs
- **Magazine Luiza:** local family owned company
- **Cencosud Brasil Comercial Ltda.:** Chilean group, a large player in the region

Source: EMIS securities

Regional Risk

Assessments: Retail

ASIA	LOW
CENTRAL & EAST. EUROPE	MEDIUM
LATIN AMERICA	MEDIUM
M. EAST & TURKEY	HIGH
NORTH AMERICA	HIGH
WESTERN EUROPE	MEDIUM

RETAIL: BRAZIL

DEMAND

After increasing by 2% in 2017, retail sales (in volume terms) expanded by 2.9% in the first six months of 2018 YoY. This continued improvement, according to statistics available from the national statistical institute IBGE, indicate that goods that have triggered the greater “appetite” include personal use items, pharmaceutical & medical items and hyper/supermarkets, foods & beverages, which grew by, respectively, 7.9%, 5.6% and 5.4% in the year up to June 2018. In the meantime, the type of goods that contributed negatively to retail sales activities during the aforementioned period include office & communication equipment (-0.5%), textile, apparel & footwear (-3.5%), fuels & lubricants (-6%) and books and newspapers (-8.8%).

However, the sector lost some temporary strength in the last two months due to the eleven-day lorry drivers strike at the end of May 2018. The standstill caused a drop of 1.2% MoM in retail activity in May and of 0.3% MoM in June 2018. Consumer confidence (according to data from August 2018) has not yet fully recovered from the negative event. For instance, the index stood at 83.8 points in August, still below the level of May (86.9 points).

For the remainder of the year and for 2019, retail sales are expected to continue recovering from the deep economic crisis of 2015-2016 at a moderate pace. Stronger demand should be supported by controlled inflation and by improvement in the credit and job markets. Regarding credit concessions for individuals with free resources, it grew by 10.2% YoY in the first seven months of 2018. Moreover, despite the relatively high local lending rate charged on loans to individuals, the average rate dropped by 11.6 p.p. in one year to July 2018 (reaching 52% per annum). Due to the strong cut in the reference interest rates Selic in recent years and the decreasing delinquency rate (at 5% down from 5.7% one year ago), there is still some space for further cuts in the lending rate. The still very high interest rate level supports this scenario and should offset the expected negative pressure coming from the external forces (thanks to the tightening monetary cycle in the US and its spill over effect on emerging economies).

It is also worth noting the low quality of the jobs that have been created (in terms of wages). While the number of unregistered and self-employed workers rose by 2.8% YoY in June 2018, the number of registered workers dropped by 1.5% in the same period. Moreover, the proximity to presidential elections should prevent a robust recovery of consumer confidence until October 2018. Afterwards, however, the dissipation of uncertainties and the relatively greater economic momentum expected for 2019 should contribute to improving the quality of jobs being created. Last but not least, it should be stressed, that the outcome of the election is still highly uncertain. Any big change in economic policy direction could jeopardize the recovery of activity.

SUPPLY

Retailers were highly exposed to Brazil’s deepest economic crisis (2015-2016). The negative impact went beyond the drop in revenues. Highly leveraged companies also struggled to deal with the rise in the cost of borrowing cost and the increase in delinquency rates.

Currently the scenario for retailers seems brighter, driven by the rebound in sales and the decrease in lending rates (despite still relatively high). The corporate delinquency rate considering the banking system dropped to 3.4% in July 2018, from 5.5% in the same month of the previous year. As a result, the lending rate charged on loans to corporates reached 20.6% per annum in July 2018, down by 4.7 p.p. from the level in June 2017. In parallel the credit concession also increased by 16% YoY in the first seven months of the year.

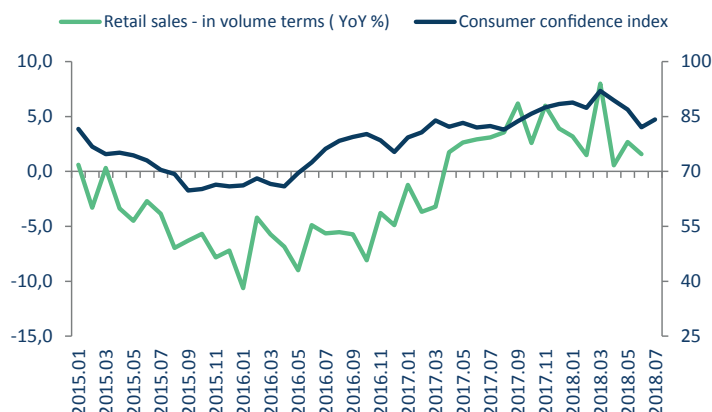
Similarly to consumption confidence, the commerce index was also hit by the lorry drivers’ strike. In July 2018, the sector’s confidence was at 89.9 points, up by 40.2% from the negative peak reached in October 2015, nevertheless still below the 96.8 points observed in March this year.

Despite the relatively stronger demand expected in the near term, there are some risks to profitability:

-The Brazilian Real depreciated by 24.5% in the year up to August 28th, impacting the profitability of imported goods. If the new government, which will take office in early January 2019, concludes significant changes to the direction of economic policy (going against fiscal consolidation) this could trigger a further currency depreciation. The latter, in its turn, could also exert upside risk on inflation

-Possible higher transportation costs represent another risk to be monitored. Triggered by the lorry drivers strike, in early August 2018, Brazil’s President Michel Temer signed into law a bill authorizing the setting of minimum truck freight prices, drawing criticism from different economic sectors (including commerce). The latter argue that this measure hurts free competition and that it will increase prices of several goods. Now, the matter is in the hands of the Supreme Court, as economic groups filed petitions challenging the constitutionality of the law. The Institute for Retail Development (IDV) conducted a survey among its members on the impact of freight shipping. The companies estimate a significant increase in the final prices of the products, generating inflation of approximately 8%.

THE EVOLUTION OF RETAIL SALES AND CONSUMER CONFIDENCE



Sources: FGV and IBGE