

Latin America's middle class

Adiós to poverty, hola to consumption

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Faster growth, low inflation, expanding credit and liberal trade are helping to create a new middle class



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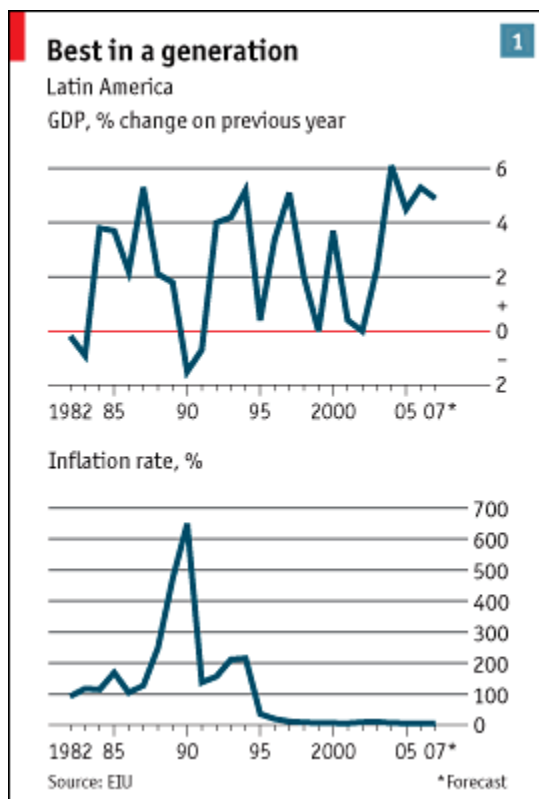
MONTANHÃO takes its name from what it used to be not long ago: a rubbish dump. On the southern extremity of São Bernardo do Campo, a suburb of São Paulo, Montanhão's houses of brick and breeze-block straggle over abrupt hills next to a reservoir. With more than 110,000 people, it is one of the few districts in Brazil's biggest city where the population is still growing fast. It is also one of the poorest. But it is not nearly as poor as it was only a decade ago. Its winding main street bustles with building-materials depots, gift and clothes shops, restaurants and several small supermarkets. One, called Dia, is part of a discount chain owned by France's Carrefour. Its closest competitor is Mercado Gonçalves, whose owner, Afonso Gonçalves, is a former street-vendor and factory electrician. Since 1997 his little shop has expanded more than fourfold to 480 square metres (5,200 square feet). It sells more than 10,000 separate items, from Nescafé and Colgate toothpaste to fresh meat, freshly baked bread and, locked in a glass case, imported whisky. According to Mr Gonçalves, "A lot of people here are very poor, but a lot are becoming middle class."

Life in places like Montanhão is still tough. Raw sewage runs in a stream not far from the supermarket. Up on the hillsides, amid a host of evangelical Protestant churches, a few houses are still made of wood. Crime is a big problem. Dora Jozina de Arruda, a young woman who runs a small kiosk on the main street selling sweets and grinding keys, says that she has been robbed twice and wants to move to a quieter neighbourhood. Some residents have clubbed

together to pay private security guards to keep drug-traffickers away. But signs of progress are all around. New tower-blocks, of the kind ubiquitous in the smarter parts of São Paulo, now jut up from among the houses of what still resembles a *favela*, or shantytown. Public services are improving fast: nearly everyone has electricity, piped water and sewerage. Smart new school buses run by the municipal government ply up and down the hillsides. And the mood of optimism is palpable. "Each year has been better than the last," says Mrs Jozina de Arruda. Between the profit from the kiosk and her husband's wages as a security guard at a bank, they earn \$900-1,200 a month. They are members of a new middle class that is emerging almost overnight across Brazil and much of Latin America. Tens of millions of such people are the main beneficiaries of the region's hard-won economic stability and recent economic growth. Having left poverty behind, their incipient prosperity is driving the rapid growth of a mass consumer market in a region long notorious for the searing contrast between a small privileged elite and a poor majority. Their advent also promises to transform the region's politics.

From the market, not the state

While poverty is measurable, the word "middle-class" is subjective. The kind of people who call themselves middle-class in Latin America tend to be at the top of the scale: prosperous professionals with several servants, children at private schools and holidays in Europe or Miami. From the 1940s to the 1970s, state-led industrialisation and the growth of public employment saw the rise in some Latin American countries of a middle class of managers,



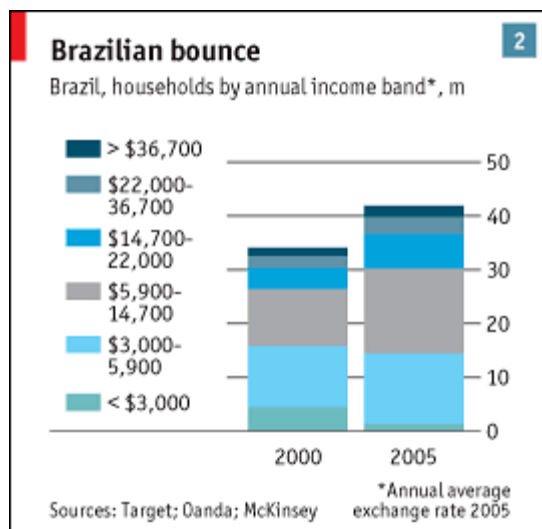
bureaucrats and a labour aristocracy of skilled workers. But the policies that pushed them up proved unsustainable; they were abandoned after the 1982 debt crisis, which triggered a decade of mediocre growth and high inflation (see chart 1). Since then, partly because protected industries were subjected to privatisation and import competition, this group has struggled. Marcio Pochmann, an economist at the University of Campinas, reckons that in Brazil 7m people dropped out of the middle class after 1980 (although 3m moved into the upper class).

The middle class that is emerging now is very different. It is more accurately described as a lower-middle class. Fernando Henrique Cardoso, a former president of Brazil who is also a sociologist, points out that this class is related more to the market than the state. Many of its members have small businesses, like Mr Gonçalves. Others act as consultants to larger concerns. José Roberto Mendonça de Barros, an economist in São Paulo, points to a plethora of small service companies which advise large Brazilian farms on computing and biotechnology. The difference is summed up by the changes in São Bernardo do Campo. A generation ago it was the heart of Brazil's car

industry, where Luiz Inácio Lula da Silva, the country's president, once led the metalworkers union in strikes. Today the car factories have shrunk or moved away, and São Bernardo lives mainly from services.

In Mexico, argues Jorge Castañeda, a political scientist, some of the new middle class come from the informal economy, others from new industries or service businesses. The class is less

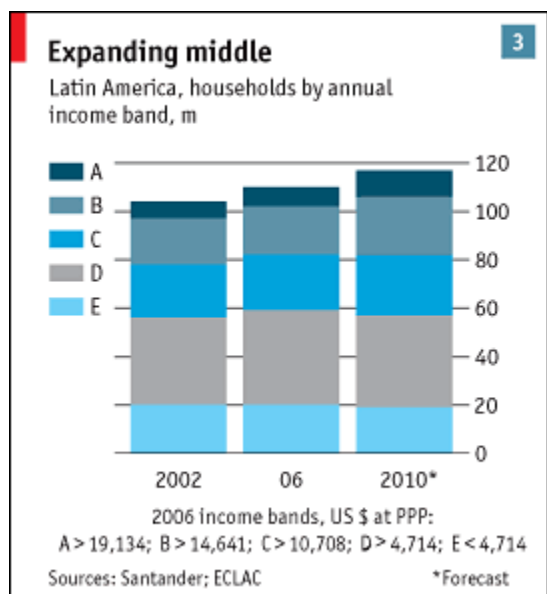
concentrated in Mexico City and is rougher-edged, culturally and socially, as well as darker-skinned, shorter and more Mexican-looking than its predecessor, he says.



These trends are furthest advanced in Chile (see [article](#)). But they are most dramatic in Brazil and Mexico, which between them account for more than half of Latin America's 560m people. In Brazil between 2000 and 2005 the number of households with an annual income of \$5,900 to \$22,000 grew by half, from 14.5m to 22.3m, while those receiving less than \$3,000 a year fell sharply to just 1.3m (see chart 2). In Mexico, according to Alejandro Hope of GEA, a consultancy in Mexico City, the number of families with a monthly income of between \$600 and \$1,600 has increased from 5.7m in 1996 to 10.7m in 2006.

Something similar is starting to happen in Colombia and Peru. In Argentina the decline of what had been a predominantly middle-class country until the 1970s reached its nadir in the economic collapse of

2001-02, when a majority of Argentines fell below the poverty line. But a rapid economic recovery has been mirrored in a revival of the middle class. Ernesto Kritz, a labour economist in Buenos Aires, reckons that around 40% of Argentine families, up from 20% in 2003, have the monthly income of \$1,000 that he sees as necessary for a middle-class lifestyle.



In Latin America as a whole, according to calculations by Banco Santander, a Spanish bank, some 15m households ceased to be poor between 2002 and 2006. If the trend continues, by 2010 a small majority in the region will have joined the middle class, with annual incomes above \$12,090 in purchasing-power-parity terms (see chart 3). In Mexico some 15m out of 27m households could have middle-class incomes by 2012, reckons Mr Hope.

The sociology of growth

Several factors lie behind these trends. The first is that, since 2004, the region's economies have grown at an annual average rate of 5%. That is not spectacular, but it is not bad (the population is growing at only around 1.4% a year). And the growth is having a bigger social impact than in the past.

In the early 1990s Latin America saw a burst of growth driven by an inflow of capital and accompanied by overvalued exchange rates. This combination tended to boost the relative price of non-tradable services, and the incomes of those in the informal economy. This period is different, says Guillermo Perry, the World Bank's chief economist for Latin America. Exports are booming, partly because of high prices for Latin America's raw materials. But the export growth also follows a round of devaluations and two decades of market-opening economic reform.

This time the growth is generating more jobs in the formal sector. In Mexico the economy grew by 4.8% last year and created 900,000 new jobs—in line with the growth of the labour force. In Brazil, too, the proportion of the labour force employed informally is starting to shrink.

Another new element is innovative social policies. In both Mexico and Brazil, one family in five now receives a small monthly stipend from the government, provided they keep their children in school and take them for health checks. Lastly, in some countries remittances from Latin Americans who have migrated help their poorer families back home. The result is that in both Brazil and Mexico the incomes of the poorest half of the population are growing faster than the average. In both countries poverty is falling steadily, and income distribution is becoming less unequal. In Mexico, although growth has been only moderate, poverty, defined as income insufficient to feed a family, fell from 37% to 14% over the decade to 2006.

The figures collated by the UN Economic Commission for Latin America and the Caribbean may understate the regional fall in poverty, since they rely on respondents answering truthfully when asked about their income. Consumption may be a better guide. The other crucial factor that is changing Latin America is low inflation, achieved because most governments have abjured deficit spending and because trade liberalisation has made many goods cheaper. Low inflation benefits the poor more than the rich, who can find ways to protect the value of their incomes. And as interest rates have fallen credit has returned. Credit is still much scarcer than in developed countries, but it is growing fast: in Brazil, for example, the stock of credit has risen to 32% of GDP from 21% in 2002. It typically starts with consumer loans for cars and durable goods, and moves on to mortgages. In Mexico the value of new mortgages has been growing by around 35% a year. That in turn has stimulated a boom in the building of new housing projects for lower-middle-class families.

Cars, jeans and pampered pets

Sales of new cars, computers and consumer electronics in both Brazil and Mexico are at record levels. Much of the extra demand has come from the new middle class. A study in 2005 of low-income families in four former *favelas* in São Paulo by the **Fernand Braudel Institute**, a think-tank in the city, found that all the households surveyed had refrigerators and colour televisions (often more than one), nearly half had mobile phones, 30% had DVD players and 29% owned a car.

Tracy Francis of the São Paulo office of McKinsey, a management consultancy, points out that social classes D to B2 (those with annual incomes from \$3,000-22,000) were responsible for 69% of total consumption in Brazil in 2005, up from 51% ten years earlier. The average woman in these social classes has 13 pairs of jeans in her wardrobe, she claims. They spend on pets, too. “Nowadays people treat their dogs and cats as if they were upper-middle-class: they feed them pet food and take them to the vet,” says Mr Gonçalves. They are also taking to the air for the first time. One cause of the recent problems in Brazil's airline industry has been its rapid growth. In Mexico, Mr Castañeda cites a survey by a new low-cost airline last year which found that 47% of its passengers had never flown before.

All these positive trends are recent and remain fragile. Mr Mendonça de Barros notes that in Brazil, until very recently, a university graduate could expect to earn less than 2,000 reais a month in his first job—roughly the same wage as a bus driver. Many of those who have clawed their way out of poverty could be knocked back down again if there were a repeat of the financial collapses the region suffered in the 1980s and 1990s.

The new middle classes have more schooling than their parents; some have gone to mushrooming private universities. But they are less educated than the old middle class that benefited from elitist public universities—and that makes moving into the upper-middle class hard.

Nevertheless, the direction of change is clear. "We are going faster towards a middle-class society than we could have imagined 20 years ago," says Mr Cardoso. "My bet is that you're crossing the threshold."

If so, this carries big implications for politics in the region. Mr Hope finds a close correlation in Mexico between home ownership and support for the ruling centre-right National Action Party. The old middle class believed in state protection. The new middle class is more self-reliant. Above all, it has benefited from economic stability. Since it has much to lose from political adventurism, it could become a force for political stability as well.