Insolvencies increase as government support ends

Atradius Economic Research – April 2022

Summary

- Global GDP growth is expected to slow in 2022, as price pressures are rising due to supply chain disruptions, strong consumer demand and the Russia-Ukraine conflict.
- In some markets, we already saw a partial return to normality in 2021 in insolvency developments. For instance, in Spain, Italy and Czech Republic, insolvencies started to rise in 2021 after they declined in 2020.
- For the majority of markets, however, the adjustment is expected to take place in 2022 and 2023. For these years, we expect insolvencies to rise in most markets as government support is phased out.

In 2022, we expect the global economy to gradually emerge from the Covid pandemic, with restrictions unwound in most countries and regions. However, in economic growth terms we see that most gains from reopening economies have already been exploited. Moreover, supply chain bottlenecks, rising consumer demand and the war in Ukraine will weigh on growth as they increase price pressures. We do, however, expect that the global economy will remain a long way from recession territory. This is because Russia and Ukraine in themselves are not large enough economies to influence global growth (they represent less than 2% of global GDP). The main effect on global growth will be via higher commodities prices. We estimate global inflation in 2022 to be 6.1%. This is having a negative impact on consumers' purchasing power and on global GDP growth, which is expected to moderate to 3.4% in 2022, compared to 5.9% in 2021.

Emerging markets as a group are forecast to grow by 3.7% in 2022, compared to 6.9% in 2021. Vaccinations will become more widely available this year, which could help output growth and improve consumer confidence. Many emerging markets are likely to turn to a less supportive monetary and fiscal policy in 2022. Central banks of some large EMEs such as Brazil, Russia and Mexico, have already taken several interest rate hikes in response to higher inflation. As fiscal and monetary support will be scaled down, this is having a moderating effect on growth. In 2022, Emerging Asia remains the fastest growing region (5.2%). In China, growth moderates to 4.8% in 2022, with constraints coming from the ailing property sector and occasional tight restrictions to fight Covid outbreaks. In Eastern Europe, Russia's economy will enter a deep recession this year (-10.9%), due to harsh sanctions imposed by Western countries. Turkey's economy is also facing a strong growth slowdown as it continues to struggle with high inflation coming from commodity prices, supply chain disruptions and geopolitical uncertainty.

Growth in the advanced economies is projected to slide to 3.1%. GDP growth in the United States is expected to moderate in 2022 due to supply chain issues and a lower fiscal impulse. Eurozone GDP growth is forecast to moderate significantly in 2022 due to supply chain disruptions and the war in Ukraine. The eurozone feels a relatively high share of the economic pain caused by the conflict between Russia and Ukraine, as it is closely linked to Russia via energy. In our baseline, we assume that the conflict will be confined to 2023 and there will be no major disruptions to oil and gas supplies to the eurozone. Worse scenarios are possible, that would further lower GDP growth in the eurozone.

While fiscal support will weaken in 2022 compared to 2021, the fiscal position continues to be expansionary in most advanced markets. Central banks are meanwhile starting to tighten monetary policy. The US Federal Reserve moved ahead with a 25 basis points rate hike in March, while the Bank of England has already implemented several rate hikes. The ECB is scaling down its asset purchasing programme, while a rate hike may likely happen in Q4 of 2022. Overall, however, financial conditions for companies remain supportive.

Mixed signals in 2021: a deepening versus a reversal of the pandemic decline in insolvencies

During the Covid-19 pandemic, we witnessed a strong decline of insolvencies (globally insolvencies fell by a cumulative 29% in 2020-2021). We have argued before that two types of policies are responsible for this development. First, most countries made changes to their insolvency legislation in order to protect companies from going bankrupt. Second, governments across the world took measures to counter pandemic-related adverse economic effects, including support for small businesses.

Chart 1 plots together the insolvency growth rates for 2020 and 2021. Most countries are situated on the left of the vertical axis, illustrating the fact that they registered a decrease in insolvencies in 2020, despite the severe economic downturn. We interpret this as the effect of generous government measures that saved not only viable companies, but also created zombie companies, i.e. the ones that would have defaulted even in normal times. The insolvencies contraction in 2020 was the highest in Singapore, Australia, France, Austria, Belgium and Italy, countries where the insolvency legislation was temporarily relaxed to protect companies from bankruptcy.

Looking along the vertical axis of Chart 1, we can see that for 2021 there was more cross-country variation in the dynamics of insolvencies. The group of countries in the south-west quadrant witnessed a deepening of the insolvency plunge, as a result of a continuation of fiscal support and possibly an increase of its effectiveness in limiting insolvencies. Among the highest decreases are found in Portugal, the Netherlands, South Korea, New Zealand and the United States.

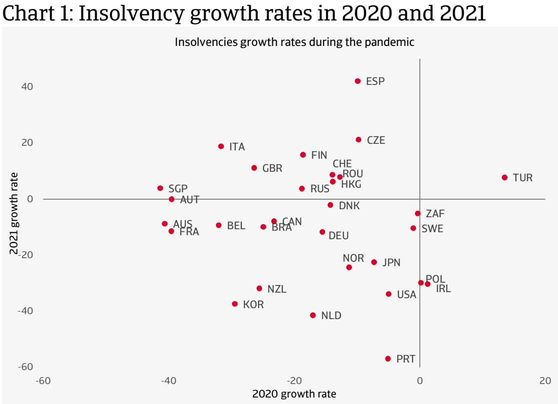
Portugal stands out with a sudden drop in insolvencies around April 2021. As the fiscal support was largely phased out around this time, we attribute the decrease to changes in Portuguese insolvency law that came into effect in November 2020 and facilitated the recovery of companies with financial difficulties. Nevertheless, this measure was also phased out in December 2021, so we expect its effect to be temporary.

New Zealand extended the option to apply for debt hibernation until October 2021, a procedure enacted as a Covid-19 related support measure. This allows businesses in financial difficulties an additional six months to find debt repayment options.

The Netherlands also exhibited a strong decline of insolvencies in 2021. While ongoing and targeted fiscal support remained in place throughout the whole year, structural changes in the insolvency law might have also played a role in decreasing insolvencies: from January 1st 2021 the Dutch insolvency law contains an additional option for restructuring.

Similarly, insolvencies filings also decreased markedly in the United States. This could be explained by the business liquidity support programmes such as the Paycheck Protection Program available until the first part of the year and the Covid-19 Economic Injury Disaster Loan offered until end of year. Additionally, the good performance of the capital markets valuation and the low interest rates offered favourable funding opportunities for debt refinancing.

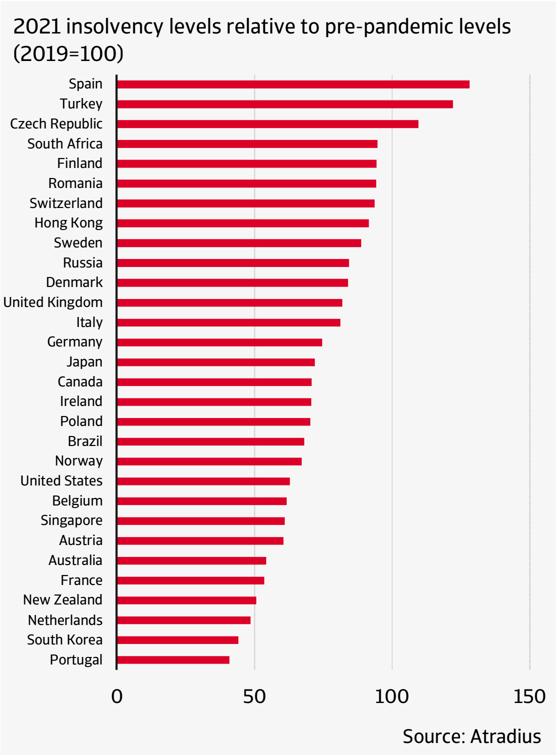
Chart 1: Insolvency growth rates in 2020 and 2021



In contrast, the countries situated in the north-west quadrant exhibit in 2021 a reversal of the pandemic insolvency contraction (i.e. they experience a positive insolvency growth in 2021, following a decline in 2020). Our interpretation is that in their case the adjustment to normal levels and possibly overshooting it due to defaults of zombie companies has already started. The strongest increases in 2021 were recorded in Spain, Czech Republic and Italy. In Spain, the economic recovery was disappointing and there are doubts about the effectiveness of a new Bankruptcy Reform Bill. In Italy, the increase in 2021 could be explained by the lifting of the bankruptcy moratorium in Q3 of 2020. In Czech Republic, most of the fiscal support was already phased out during 2021, which could explain the increase there.

Chart 2 gives the insolvencies index in 2021 relative to their level in 2019. This can be seen as an alternative representation of the joint effect of the growth rates from chart 1 on the insolvencies level in 2021 relative to 2019. The index shows a wide variation, with Portugal, South Korea and the Netherlands registering less than half of the insolvency levels in 2019, while Spain, Turkey and the Czech Republic are already overshooting it. We highlight here the deviation of insolvencies from their level in 2019 as this is key driver of our insolvencies forecast, as we discuss in the next section.

Chart 2: Stark cross-country differences in the 2021 insolvency levels relative to pre-pandemic



2022 and 2023: The return to normality and additional defaults from zombies

Most governments have support programs in place until the end of 2021 or the first half of 2022. After the first half of 2022, in most countries government support will have been phased out. Therefore, we expect that in general insolvency levels will start to adjust to normal levels in 2022. We quantify the normal level of insolvencies at a given point in time on the forecasting horizon by taking as a benchmark the insolvency counts in 2019 and adjusting this with the effect of the change in GDP deviation from trend vis-à-vis 2019.

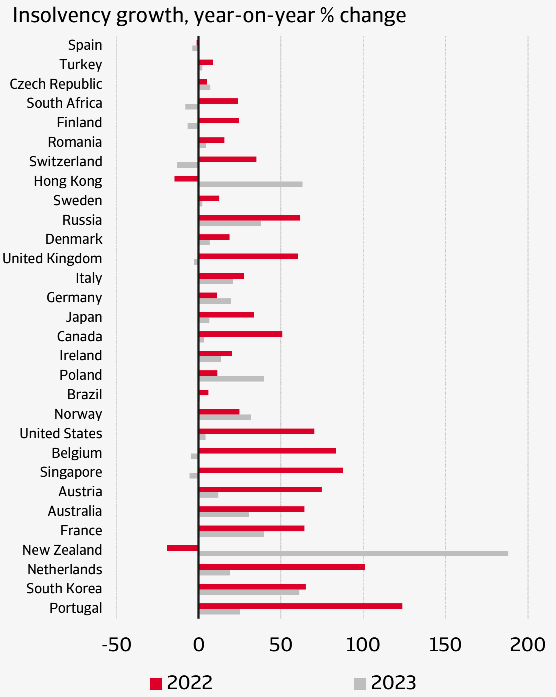
The Russia-Ukraine conflict influences our insolvency forecast via the negative impact on GDP growth, which will be significant for Russia itself, and to a lesser extent will be felt in other markets. However, compared to the phasing out of government support measures, the impact of the Russia-Ukraine conflict on insolvency projections is relatively small outside Russia.

For many of the observed markets, we forecast an overshooting of the normal level of insolvencies in the second half of 2022 or the start of 2023. This comes as a result of additional defaults coming from zombie companies. The latter are likely to occur because in the pandemic period the insolvency levels contracted well below their pre-pandemic levels. We believe that these companies will default after the government support is withdrawn. In general, by the end of 2023 we see a flattening out of the insolvencies to normal levels.

As said, the timing of the government support withdrawal is essential for our insolvency projection. We make two key assumptions. First, we assume that the return to normality will take place gradually in the first two quarters after the withdrawal of the fiscal support. Moreover, we assume that the zombie companies will default in the next four quarters following the withdrawal of the fiscal support. Therefore, an earlier withdrawal the fiscal support will mean that most of the insolvency increases are concentrated in 2022, whereas a later date means that there will be a higher concentration in 2023.

We present in Chart 3 the 2022 and 2023 growth rates for all the markets in our analysis arranged in decreasing order of the insolvency level in 2021 relative to 2019, as in Chart 2.

Chart 3: Insolvencies forecast to rise most in countries coming from a low level in 2021



Source: Atradius

We see that, in general, the growth rates are higher for countries that had lower insolvency levels in 2021 relative to their pre-pandemic level. These high growth rates reflect the adjustment to the normal level of insolvencies and the occurrence of zombie defaults. Notice that, in general, countries with high growth rates in 2022 experience low growth rates in 2023 and vice-versa, depending on the timing of the fiscal support withdrawal in each country.

The highest rates for 2022 are recorded in Portugal, Netherlands, Singapore, Belgium, Austria and United States, countries with low insolvency levels in 2021 and that additionally experienced withdrawal of the fiscal support in late 2021 or early 2022.

Russia is also forecast to experience a significant increase in insolvencies in 2022, partially due to the adjustment to normal and partially due to the economic recession induced by the sanctions related to the war in Ukraine.

On the other side of the spectrum, for Spain, Czech Republic, Finland, Switzerland and Romania insolvencies grow by a smaller percentage because in their case most or all of the adjustment to normal took place in 2021.

For Sweden we see lower rates in 2022 because its deviation from normal in 2021 was not that large.

Turkey and Brazil are forecasted to experience some of the lowest increase in 2022, but not because of the pandemic related adjustment, as fiscal support was already phased out in 2020. Instead, our forecast for these countries reflects a deterioration of GDP growth relative to its long-term trend.

Two striking outliers are New Zealand and Hong Kong, with a decreases of insolvencies in 2022. This is because in their case the fiscal support is expected to extend until the end of 2022. This effectively concentrates all the adjustment in 2023, therefore inflating the growth rate to the highest across all markets.

We note that the 2023 growth rates of insolvencies are also on the high side for South Korea, Poland, France, Norway and Australia. Similarly, these reflect relatively low insolvency levels in 2021 and a later withdrawal of the fiscal support in mid-2022. As a result, in their case the insolvency levels will still be high at the start of 2023 and they will progressively normalise throughout the year, leading to a high insolvency levels for the full year.

Beyond 2023, we expect that insolvencies will again start to decline or remain approximately constant. This is because insolvency levels will have largely returned to normal and zombie firms that are not able to survive without support, have gone bankrupt already. In the coming years, firms will have to adjust to an environment without significant government support. For firms that have taken up a lot of debt during the pandemic, this could be a challenge.

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Table 1 Total insolvencies - annual percentage change

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021e	2022f	2023f
Australia	2	9	1	2	-19	16	-16	-8	3	3	-41	-9	64	31
Austria	-8	-8	3	-10	-1	-5	1	-3	-2	1	-40	0	75	12
Belgium	2	7	4	11	-9	-9	-6	9	-1	7	-32	-9	83	-5
Brazil	-19	-12	7	8	-1	12	-13	29	0	-1	-25	-10	6	1
Canada	-11	13	-11	-2	-2	-1	-7	-6	-1	3	-23	-8	51	3
Czech Republic	-	-	-	-	-	-	-10	-15	-16	4	-10	21	5	7
Denmark	-3	-22	4	-15	-21	15	18	-4	7	6	-14	-2	19	7
Finland	-13	3	0	6	-5	-14	-6	-10	17	3	-19	16	24	-7
France	-5	-1	3	3	0	0	-8	-6	-1	-5	-40	-11	64	40
Germany	-2	-6	-6	-8	-7	-4	-7	-7	-4	-3	-16	-12	11	20
Hong Kong	-43	-13	2	15	3	1	-9	-14	-6	9	-14	6	-15	63
Ireland	8	7	3	-19	-15	-10	-2	-15	-13	-25	1	-30	20	14
Italy	20	8	3	13	11	-6	-9	-11	-8	0	-32	19	28	21
Japan	-14	-4	-5	-10	-10	-8	-6	0	-2	2	-7	-22	34	6
Netherlands	-9	0	19	10	-22	-24	-19	-22	-9	4	-17	-41	101	19
New Zealand	-5	-12	-7	-13	-7	4	3	-22	-7	-18	-26	-32	-19	188
Norway	-17	0	-13	18	6	-3	-1	4	12	3	-11	-24	25	32
Poland	-	4	24	1	-9	-7	-19	-2	4	-5	0	-30	11	40
Portugal	21	-5	46	1	-13	12	-6	-16	-4	-8	-5	-57	124	25
Romania	-	-9	36	10	-30	-50	-18	9	-9	-21	-13	8	16	5
Russia	8	-18	-6	9	18	1	-3	7	-3	-6	-19	4	62	38
Singapore	-25	-1	14	14	-12	1	1	-9	1	-1	-41	4	88	-6
South Africa	-3	-11	-24	-13	-13	-5	-1	-3	-1	11	0	-5	24	-8
South Korea	-21	-13	-10	-18	-16	-14	-23	-11	-5	-12	-29	-37	65	61
Spain	-4	18	37	13	-28	-22	-16	-1	2	11	-10	42	-1	-4
Sweden	-4	-4	7	4	-6	-11	-5	6	13	2	-1	-10	13	2
Switzerland	20	6	3	-5	-10	4	7	3	22	-3	-14	9	35	-13
Turkey	-	12	7	8	-9	-13	-10	19	-8	3	14	8	9	2
United Kingdom	-19	4	-4	-9	-8	-10	1	-1	10	7	-26	11	60	-3
United States	-7	-15	-16	-17	-19	-8	-2	-4	-4	3	-5	-34	70	4

Sources: Atradius, Macrobond, national sources

Table 2 Total insolvencies - index, 2010 = 100

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021e	2022f	2023f
Australia	100	109	111	113	92	106	89	81	84	87	51	47	77	101
Austria	100	92	95	86	85	81	82	80	78	79	48	48	83	93
Belgium	100	107	111	123	112	102	96	104	103	111	75	68	125	119
Brazil	100	88	94	102	101	113	98	127	127	126	94	85	90	90
Canada	100	113	100	98	96	95	89	83	83	85	65	60	91	94
Czech Republic	-	-	-	-	-	100	90	77	65	68	61	74	78	83
Denmark	100	78	81	69	54	62	73	70	75	80	69	67	80	85
Finland	100	103	103	109	104	90	84	76	89	92	75	86	107	100
France	100	99	101	105	104	104	96	91	90	85	52	46	75	105
Germany	100	94	88	81	75	72	67	63	60	59	50	44	49	58
Hong Kong	100	87	89	102	106	106	97	83	78	85	73	78	66	108
Ireland	100	107	110	90	76	69	68	57	50	37	38	26	32	36
Italy	100	108	112	126	140	131	120	107	99	99	67	80	102	123
Japan	100	96	91	81	73	67	63	63	62	63	58	45	60	64
Netherlands	100	100	120	131	102	77	63	49	45	46	38	22	45	54
New Zealand	100	88	82	71	66	69	71	55	51	42	31	21	17	50
Norway	100	100	87	103	109	105	105	109	123	127	112	85	106	140
Poland	-	104	129	130	119	110	89	87	90	86	86	60	67	94
Portugal	100	95	139	140	121	136	128	108	104	96	91	39	88	110
Romania	-	91	124	136	95	47	39	42	38	30	26	28	33	34
Russia	100	82	78	85	100	101	97	105	102	95	78	80	130	179
Singapore	100	99	114	130	114	116	117	107	108	107	63	65	122	116
South Africa	100	89	68	59	52	49	48	47	46	51	51	48	60	55
South Korea	100	87	78	64	54	46	35	31	30	26	19	12	19	31
Spain	100	118	162	183	132	102	86	85	87	96	86	123	121	116
Sweden	100	96	103	106	99	88	84	89	101	103	102	91	103	105
Switzerland	100	106	109	104	94	97	104	107	131	127	109	118	160	139
Turkey	-	112	119	129	118	102	92	109	101	105	119	128	139	142
United Kingdom	100	104	99	90	83	74	75	75	82	88	65	72	115	112
United States	100	85	71	59	48	44	43	41	40	41	39	25	43	45

Sources: Atradius, Macrobond, national sources

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