Insolvency increases expected amid phase-out of fiscal support

Atradius Economic Research – October 2021

Summary

- The world economy is expected to show robust growth rates in 2021 and 2022. However, downside risks remain that could slow the recovery, such as the Delta variant and supply chain bottlenecks.
- At the end of 2022, insolvencies are expected to be elevated compared to pre-pandemic levels in most observed markets. This can be largely attributed to bankruptcies of businesses that were 'saved' by government support in 2020, and the return of insolvencies to 'normal' levels. In some cases, a slow economic recovery additionally contributes to higher insolvencies.
- Countries where we expect the highest cumulative growth in insolvencies in 2021 and 2022 compared to pre-pandemic levels are Italy (+34%), United Kingdom (+33%) and Australia (+33%).

Global insolvencies declined by 14% in 2020, the year the world economy was plunged into recession by the Covid-19 pandemic. In 2021, we expect a modest 1% decrease, a significant downward adjustment compared to our forecast in early 2021. The still low level of business failures this year is owing to the extension of fiscal measures in many countries, and in some cases also due to the continuation of insolvency law amendments. On a regional level, we see rising insolvencies in Europe in 2021, while the trend is positive (downwards) in North America and in the Asia-Pacific region.

In 2022, we expect global insolvencies to increase by 33%, as fiscal support will be completely phased out by then in most markets. This will cause a 'return to normal' in the insolvency level, together with insolvencies of a certain share of businesses that were 'saved' from bankruptcy in 2020. As a result, the level of insolvencies in all three regions will increase.

Delta variant may slow recovery in 2021

With vaccination campaigns ongoing, the global economy is on a recovery path from the 2020 economic downturn caused by the Covid-19 pandemic. Global GDP is expected to recover by 5.8% in 2021, after a 3.5% decline in 2020. The 2021 growth rate is slightly lower than expected six months ago, due to the spread of new, more transmissible variants of Covid-19, in particular the Delta variant. This has caused a slower easing of restrictions, affecting the pace of rebound. As most economies have not yet fully re-opened, in many cases fiscal support has been partially extended in 2021, while monetary policies remain loose, despite rising inflationary pressures.

The pace of recovery is uneven across advanced markets, with generally high vaccination rates, and emerging markets, with slower vaccination roll-outs. Vaccination rates in the largest European economies are roughly between 70% and 80% (at least one shot). The United States was one of the front-runners in vaccination rollout, but several European countries currently record higher vaccination rates (the US remains stuck at 64%). Emerging economies generally have lower vaccination rates compared to advanced economies. Between 20% and 75% of population have been vaccinated in large emerging countries like China, India, Turkey, Brazil, and South Africa.

We see the Delta variant as the most important downside risk to our economic forecast. Infections are rising again in some major advanced markets. Several countries (Japan, Australia, New Zealand) have re-imposed or extended restrictions, as new Covid-19 cases have surged. The Delta variant is also a threat to emerging markets with lower vaccination rates, such as Brazil, Russia, Turkey, and South Africa.

Another downside risk for economic growth are the current supply chain bottlenecks, which are pushing up delivery times and production costs. With some sector-specific exceptions (notably the semiconductor shortage in the automotive industry), supply chain disruptions in most sectors should begin to unwind as of H2 of 2021. Additionally, the reopening of consumer services and diminishing fiscal support are expected to lead to lower demand for goods. However, should supply chain disruptions last longer than expected, they could potentially hamper the economic recovery.

We expect Eurozone GDP to recover by 5.1% in 2021, after a 6.5% contraction in 2020. As the vaccination rollout is ongoing, restrictions are being lifted. Surveys indicate a strong recovery in services performance, as high-contact activities are normalised. In general, countries that suffered the deepest recessions in 2020 will witness the strongest rebound in 2021. We see a relatively strong recovery in countries that imposed stringent pandemic-related restrictions in 2020, such as Spain, France and Italy. As tourism picks up, countries with a high dependency on this sector (Portugal, Spain, Italy, and France) will see the recovery helped by tourism inflows. However, tourism flows will not fully rebound in the coming two years, as some people still shy away from traveling in order to limit health risks, while not all safeguarding measures have been completely abandoned. In 2022, GDP growth in the eurozone is expected to be relatively robust, at 4.4%.

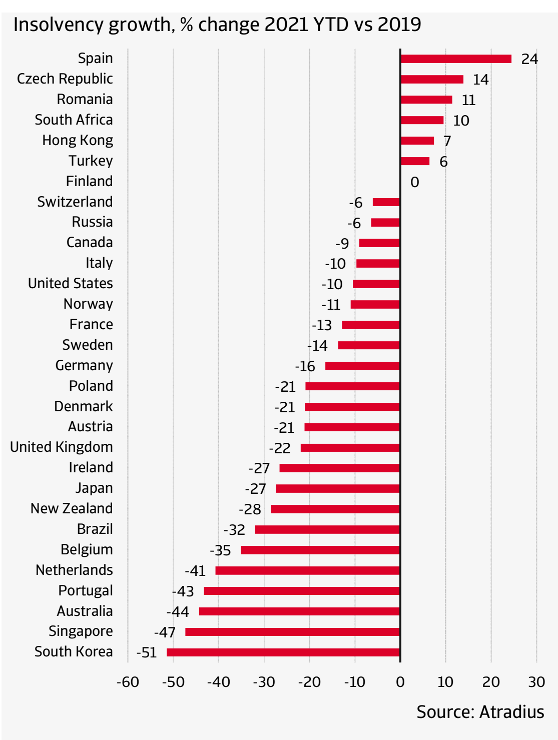
The economic outlook for the United Kingdom has improved since early 2021. Activity proved more resilient than expected during the third national lockdown, and has rebounded strongly in Q2 of 2021, as restrictions began to ease. The British economy is forecast to grow 6.9% in 2021, but is not expected to reach its pre-pandemic level before 2022. Consumers are driving the recovery, with strong growth in the hospitality sectors. This momentum is expected to continue, as the last remaining restrictions have been lifted. However, input shortages have led to serious activity constraints in the manufacturing sector. This issue is expected to gradually ease in H2 of 2021, but not to disappear completely until 2022.

Outside of Europe, economic activity in the United States already surpassed its pre-pandemic level in Q2 of 2021, with GDP expanding 6.1% year-on-year. The vaccination rollout and the reopening of the economy in H1 have strongly contributed to the recovery. However, growth has been affected by supply chain issues, which has limited the capacity for inventories to restock in order to meet strong domestic demand. The US economy is forecast to expand 5.5% in 2021, led by strong domestic demand as the labour market rapidly recovers. A USD 1.9 trillion fiscal stimulus package approved by Congress in spring has provided additional contribution to growth. In 2022, there is further potential boost from the USD 1.7 trillion American Jobs Plan (AJP). GDP is forecast to grow 4.4% next year, which is still robust due to inventory rebuild.

Australia's GDP recovered faster than expected in Q2 of 2021, expanding 0.7% quarter-on-quarter. However, the economy has suffered from an outbreak of the Delta variant over the past couple of months, with daily infections rising to record levels. The pace of vaccination rollout has been comparatively low so far, with about 65% of the population having received at least one dose. While the pace of vaccination has picked up in recent weeks, GDP is expected to contract in Q3 due to reimposed lockdowns, with full-year growth estimated at 2.9%. This will be followed by an expected 3.8% GDP expansion in 2022.

Japan experienced a 4.7% GDP contraction in 2020, likely to be followed by a partial recovery of 2.4% in 2021. The Delta variant drove a wave of infections over the summer, clouding the Q3 outlook. State-of-emergency has been re-imposed in major cities in July, likely to affect mobility and consumption activities well into September. Vaccination is rapidly increasing, but still lags behind other major economies. In 2022, GDP is expected to grow 2.8%, supported by robust exports and a recovery in consumption.

Chart 1: Insolvency development 2021 YTD vs 2019

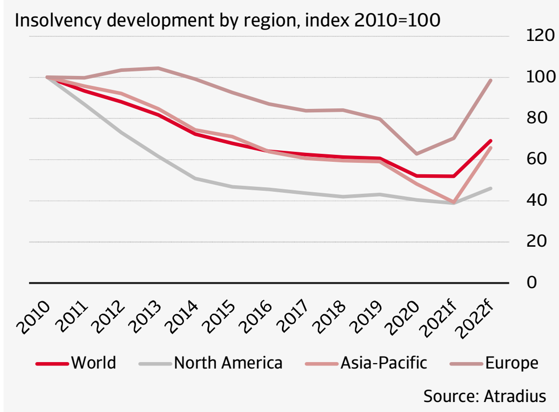


Current insolvency levels artificially low due to government support

Contrary to expectations at the beginning of the pandemic, business insolvencies did not increase in 2020 on a global level. The global insolvency index even decreased last year, by 14%. In our previous insolvency report we argued that two types of policies are responsible for this development. First, most countries made changes to their insolvency regime in order to protect companies from going bankrupt. Second, governments across the world have taken measures to counter pandemic-related adverse economic effects, and to support small businesses.

In Europe, countries like France, Belgium, Italy and Spain enacted laws in 2020 that temporarily froze bankruptcy proceedings or declared bankruptcies inadmissible. Outside of Europe, Australia has increased the debt threshold for companies to declare bankruptcy. All those countries witnessed a sharp decrease in insolvencies in 2020. Countries that made fewer or no changes to their insolvency laws generally recorded a smaller decrease in insolvencies. Examples are Sweden, Denmark, the Netherlands, Ireland, Japan, and the United States.

Chart 2: Insolvency development by region



In addition to insolvency law changes, fiscal support measures have also played a crucial role in keeping insolvency levels low. The most effective form of government measures have been direct fiscal spending and tax breaks. European countries with extensive fiscal support measures are Germany, France, Austria, Belgium, the Netherlands, and the United Kingdom. Outside of Europe, the United States, Canada, Australia, and Japan have all implemented substantial fiscal support packages, which contributed to very low insolvency levels in 2020 compared to GDP contraction.

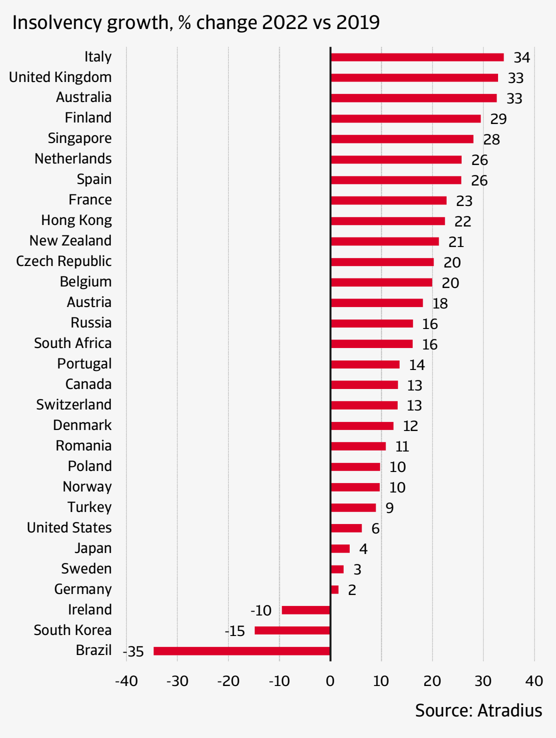
Looking at the 2021 insolvency figures, levels remain very low in general, mainly due to extended fiscal support in many countries. Chart 1 compares the 2021 year-to-date level of insolvencies with the pre-pandemic level in 2019. It shows that insolvencies are much lower in most markets, even down 51% in South Korea, 47% in Singapore, and 44% in Australia. This suggests that fiscal support packages (and in the case of Australia and Singapore also significant adjustments to legal frameworks) have been particularly effective.

However, the sharp decreases in most countries also suggest that that potentially many so-called 'zombie companies' have been created. The term is loosely defined here as companies that may not survive once economic circumstances return to normal, as their financial situation is too weak. That said, due to low interest rates, they may survive for some time at least.

Business insolvencies expected to increase in H2 of 2021 and in 2022

Our expectation is that insolvencies will increase in most markets in H2 of 2021 and in 2022. In 2021, global insolvencies are forecast to show a modest 1% year-on-year decrease, followed by a sharp 33% increase in 2022.

Chart 3: Insolvency development 2022 vs 2019

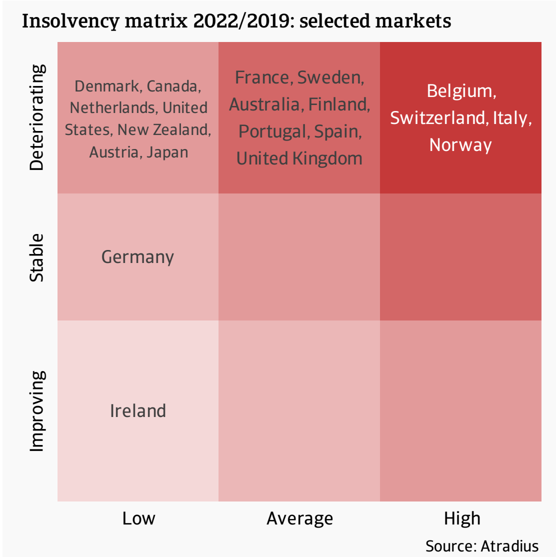


The 2021 insolvency projection has been significantly revised downwards compared to our March 2021 insolvency report, mainly due to extended fiscal support in many markets. However, as support schemes are phased out in H2 of 2021, the normal relationship between GDP and insolvencies - that is, the historical negative correlation between the two variables - will be restored in 2022, and many delayed insolvencies will finally materialise.

The insolvency forecast in 2021-2022 is shaped by three forces. First, there is a delayed effect of bankruptcies that under normal circumstances (no fiscal package, no insolvency moratoriums) would have occurred in 2020.

We assume that a share of businesses that were ‘saved’ from bankruptcy in 2020 will face insolvency in the first twelve months after fiscal support has expired. Our view is that thanks to the support packages, businesses will have a reasonably strong cash position for the time being. Those with an unsustainable financial position (zombie companies) can buy themselves time by running down their cash. We expect that these zombies will materialize into bankruptcies over four quarters after the end date of fiscal support.

Chart 4: Insolvency matrix 2022 vs 2019



The second force shaping the insolvency forecast is the phasing out of fiscal support itself, which in general will trigger an increase of insolvencies towards ‘normal’ levels, similar to the ones registered in the pre-pandemic period. In about half of the observed markets fiscal support phased out already in H1 of 2021 or even earlier. Examples of countries where support ended relatively early are Brazil, Turkey and Russia. For the other half, stimulus will be phased out in H2 of 2021, or even later. For example, in Australia, Ireland, Japan, Spain and Sweden support will continue until Q4 of 2021. In South Korea, fiscal stimulus is even extended until Q2 of 2022.

The third factor shaping the insolvency forecast is the effect of economic developments, which depends on two factors: the gap between GDP and potential GDP (strength of the recovery), and how responsive insolvencies are to this GDP gap. This factor captures how insolvencies respond to the economic cycle. Based on historical relationships, we know insolvencies generally decline in expansive economic cycles and increase when growth slows or even declines. The responsiveness is called ‘elasticity’ in economics and measures the degree to which insolvencies change in response to GDP changes.

On a regional level we expect an increase of insolvencies in Europe this year, while the trend will be still downwards in North America and the Asia Pacific (see Chart 2). In North America, insolvencies are still very low due to strong US fiscal support and a robust economic recovery. In the Asia Pacific, fiscal support is also sustained relatively long. In 2022, insolvencies will increase in all three regions, with the highest rise expected in Asia-Pacific, and somewhat lower increases in Europe and North America. While the increase in

Asia-Pacific is from a low base in 2021, in North America the rise is somewhat limited by the relatively strong US growth. In Europe, insolvencies are expected to grow for the second year in a row.

Looking at the forecast for 2021 and 2022 on a country level, we see that by 2022 the level of insolvencies will still be elevated compared to pre-pandemic levels. The combination of delayed insolvencies from 2020, the return of insolvencies to 'normal' levels as fiscal support is phased out, and the effect of GDP growth on insolvencies, cause bankruptcies to increase in most observed markets (see Chart 3 and Chart 4). In Italy (+34%), the United Kingdom (+33%) and Australia (+33%) insolvencies will be the highest compared to pre-pandemic levels. In Australia the increase occurs mainly in 2022 due to the expiry of fiscal support towards the end of 2021. In Italy and the United Kingdom, the increase is distributed over both 2021 and 2022, but the highest increase takes place in 2022.

In the Netherlands, the insolvency level in 2022 is also relatively high (+26%) compared to pre-pandemic levels. The increase in the case of the Netherlands will only take place in 2022, as fiscal support keeps the level low in 2021. Other major economies such as Spain (+26%), France (+23%) and the United States (+6%), can also expect elevated insolvency levels in 2022. In Spain, the limited economic recovery pushes up insolvencies mainly in 2021. In France, the increase is distributed over both 2021 and 2022, driven by the bankruptcy of zombie firms and phasing out of fiscal support by Q2 2021. For the United States, we expect a 6% higher level of insolvencies in 2022 compared to 2019. The increase takes place in 2022 only, but is more limited due to the strong economic recovery and also because insolvencies did not decrease that much in 2020-2021, so there is a weaker base effect.

Some countries show a relatively stable insolvency development up to 2022. Examples are Germany (+2%), and to a lesser extent also Sweden (+3%) and Japan (+4%). In those markets the level of insolvencies returns more or less to normal, despite the pandemic. The year-on-year dynamics can be strong, however, as Table 1 in the appendix shows. For instance, Germany recorded a 16% insolvency decrease in 2020, with another 1% decline expected in 2021, but followed by a forecast 22% increase in 2022. The net effect is a slightly elevated level compared to pre-pandemic levels.

Brazil (-35%), South Korea (-15%) and Ireland (-10%) are the only markets with substantially lower insolvencies in 2022 compared to 2019 levels. In Ireland, insolvencies did not decline that steeply in 2020, and therefore the base effect is smaller. Moreover, fiscal support continues until Q4 of 2021, while the strength of the economic recovery is also reducing insolvencies. In South Korea, the long extension of fiscal support is also the reason behind the still low level of insolvencies expected in 2022. In Brazil, the economic recovery is sufficiently strong keep insolvencies at the current low level over the coming two years.

Beyond 2022, we expect that insolvencies will again start to decline or remain 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. It is clear that the phasing out of fiscal support could present challenges to some firms in the short run, as they once again have to operate in an environment without significant government support. Some firms are especially vulnerable as they have taken up higher debt to survive the corona pandemic.

Theo Smid, Senior Economist
theo.smid@atradius.com
+31 20 553 2169

Iulian Ciobica, Economist
iulian.ciobica@atradius.com
+31 20 553 2121

Table 1 Total insolvencies - annual percentage change

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021f	2022f
Australia	2	9	1	2	-19	16	-16	-8	3	3	-41	-6	138
Austria	-8	-8	3	-10	-1	-5	1	-3	-2	1	-40	30	50
Belgium	2	7	4	11	-9	-9	-6	9	-1	7	-32	-4	85
Brazil	-19	-12	7	8	-1	12	-13	29	0	-1	-25	-9	-4
Canada	-11	13	-11	-2	-2	-1	-7	-6	-1	3	-23	19	24
Czech Republic	-	-	-	-	-	-	-10	-15	-16	4	-10	26	6
Denmark	-3	-22	4	-15	-21	15	18	-4	7	6	-14	-8	42
Finland	-13	3	0	6	-5	-14	-6	-10	17	3	-19	23	29
France	-5	-1	3	3	0	0	-8	-6	-1	-5	-40	44	41
Germany	-2	-6	-6	-8	-7	-4	-7	-7	-4	-3	-16	-1	22
Hong Kong	-43	-13	2	15	3	1	-9	-14	-6	9	-14	25	14
Ireland	8	7	3	-19	-15	-10	-2	-15	-13	-59	1	-27	23
Italy	20	8	3	13	11	-6	-9	-11	-7	-1	-32	32	48
Japan	-14	-4	-5	-10	-10	-8	-6	0	-2	2	-7	-22	43
Netherlands	-9	0	19	10	-22	-24	-19	-22	-9	4	-17	-29	112
New Zealand	-5	-12	-7	-13	-7	4	3	-22	-7	-18	-26	-4	69
Norway	-17	0	-13	18	6	-3	-1	4	12	3	-11	0	23
Poland	-	4	24	1	-9	-7	-19	-2	4	-5	0	-21	39
Portugal	21	-5	46	1	-13	12	-6	-16	-4	-8	-5	-40	100
Romania	-	-9	36	10	-30	-50	-18	9	-9	-21	-13	28	0
Russia	8	-18	-6	9	18	1	-3	10	-4	-53	-19	15	24
Singapore	-25	-1	14	14	-12	1	1	-9	1	-1	-41	-10	143
South Africa	-3	-11	-24	-13	-13	-5	-1	-3	-1	11	0	10	6
South Korea	-21	-13	-10	-18	-16	-14	-23	-11	-5	-12	-29	-31	75
Spain	-4	18	37	13	-28	-22	-16	-1	2	11	-10	38	1
Sweden	-4	-4	7	4	-6	-11	-5	6	13	2	-1	-13	19
Switzerland	20	6	3	-5	-10	4	7	3	22	-3	-14	10	20
Turkey	-	12	7	8	-9	-13	-10	19	-8	3	14	-6	2
United Kingdom	-18	4	-4	-9	-8	-10	1	-1	10	7	-27	7	70
United States	-7	-15	-16	-17	-19	-8	-2	-4	-4	3	-5	-6	18

Sources: Atradius, Macrobond, national sources

Table 2 Total insolvencies - index, 2010 = 100

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021f	2022f
Australia	100	109	111	113	92	106	89	81	84	87	51	48	115
Austria	100	92	95	86	85	81	82	80	78	79	48	62	93
Belgium	100	107	111	123	112	102	96	104	103	111	75	72	133
Brazil	100	88	94	102	101	113	98	127	127	126	94	85	82
Canada	100	113	100	98	96	95	89	83	83	85	65	77	96
Czech Republic	-	-	-	-	-	100	90	77	65	68	61	77	81
Denmark	100	78	81	69	54	62	73	70	75	80	69	63	90
Finland	100	103	103	109	104	90	84	76	89	92	75	92	119
France	100	99	101	105	104	104	96	91	90	85	52	74	105
Germany	100	94	88	81	75	72	67	63	60	59	50	49	60
Hong Kong	100	87	89	102	106	106	97	83	78	85	73	91	104
Ireland	100	107	110	90	76	69	68	57	50	20	21	15	18
Italy	100	108	112	126	140	131	120	107	99	99	67	89	132
Japan	100	96	91	81	73	67	63	63	62	63	58	46	65
Netherlands	100	100	120	131	102	77	63	49	45	46	38	27	58
New Zealand	100	88	82	71	66	69	71	55	51	42	31	30	51
Norway	100	100	87	103	109	105	105	109	123	127	112	113	139
Poland	-	104	129	130	119	110	89	87	90	86	86	68	94
Portugal	100	95	139	140	121	136	128	108	104	96	91	54	109
Romania	-	91	124	136	95	47	39	42	38	30	26	34	33
Russia	100	82	78	85	100	101	98	107	103	48	39	45	56
Singapore	100	99	114	130	114	116	117	107	108	107	63	56	137
South Africa	100	89	68	59	52	49	48	47	46	51	51	56	59
South Korea	100	87	78	64	54	46	35	31	30	26	19	13	22
Spain	100	118	162	183	132	102	86	85	87	96	86	119	121
Sweden	100	96	103	106	99	88	84	89	101	103	102	89	106
Switzerland	100	106	109	104	94	97	104	107	131	127	108	119	143
Turkey	-	112	119	129	118	102	92	109	101	105	119	111	114
United Kingdom	100	104	99	90	83	74	75	75	82	88	64	69	117
United States	100	85	71	59	48	44	43	41	40	41	39	36	43

Sources: Atradius, Macrobond, national sources

If you've found this economic update useful, why not visit our website www.atradius.com, where you'll find many more Atradius publications focusing on the global economy, including country reports, industry analysis, advice on credit management and essays on current business issues.

Connect with Atradius
on social media

Disclaimer

Atradius N.V.
David Ricardostraat 1 – 1066 JS Amsterdam
Postbus 8982 – 1006 JD Amsterdam
The Netherlands
Phone: +31 20 553 9111

info@atradius.com
www.atradius.com