Insolvency forecasts: approaching a turning point

Atradius Economic Research – August 2018

Summary

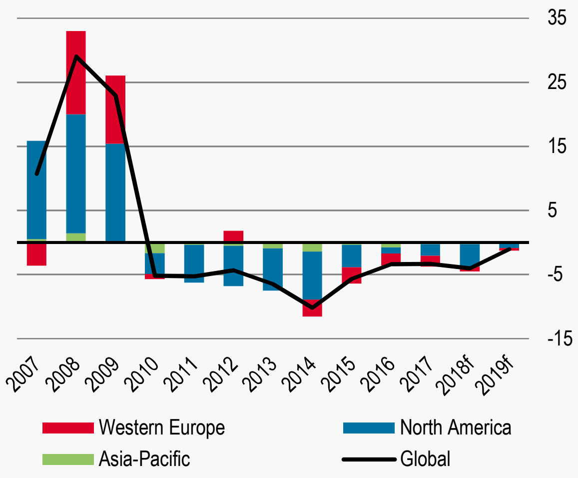
- The global upswing is driving another projected 4% decline in insolvencies across advanced markets this year. Broad-based economic growth and still-low interest rates underpin the improvement, but we are reaching a turning point.
- Risks to the global outlook are increasing, especially stemming from trade policy uncertainty and monetary tightening. This will likely put the brakes on the downward trend in global insolvencies with only a 1% decline forecast for 2019.

Benign outlook to lose steam in 2019

The global economy remains healthy with a broad-based upswing bringing GDP growth to 3.1% this year, the fastest expansion since 2011. Insolvencies across advanced markets are expected to decrease 4.6% overall this year, a projected 0.5 percentage points better than last quarter's forecast. The more optimistic outlook is driven by the strong performance of the US economy in H1. But global growth is losing momentum as downside risks, especially from trade policy uncertainty, increase, warranting a more cautious outlook for 2019. GDP growth is forecast to ease to 2.9% in 2019, bringing along with it a smaller drop in insolvencies of only 1.2%. On top of slowing GDP growth and higher uncertainty surrounding international trade policy, companies around the world are facing higher financing costs and changing consumer preferences. As such, insolvency developments are expected to stabilise in 2019.

1 Insolvencies decline is beginning to turn around

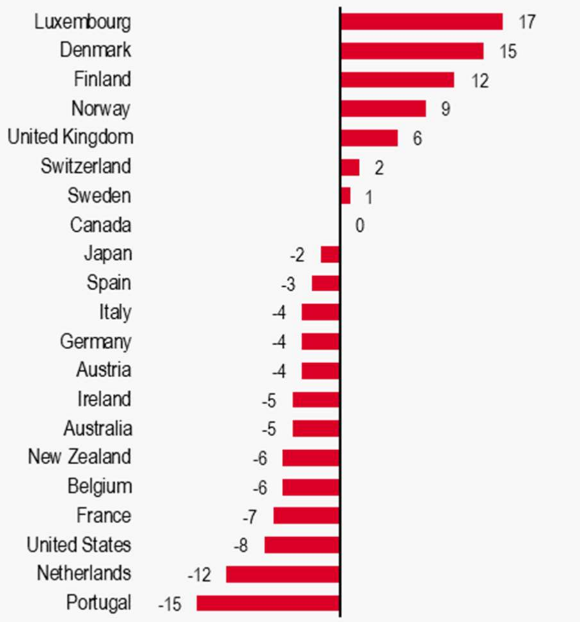
Global insolvency growth, regional contributions



Source: Atradius

2 Insolvency outlook 2018

% change y-o-y



Source: Atradius

3 Insolvency outlook 2019

% change y-o-y

Source: Atradius

Eurozone – robust performance

Economic strength in the eurozone has been one of the key drivers of the broad-based global upswing since 2017. The outlook for 2018 remains strong however we expect momentum to begin to ease in 2019. The outlook is characterised by robust GDP growth, declining unemployment, and strong business and consumer confidence, key positive drivers for the insolvency rate. Following a decline of 6.7% in 2017, eurozone insolvencies are projected to fall 5% this year and only 1.8% in 2019. The threat of protectionism, a hard Brexit, and political uncertainty in Italy are downside risks to the positive outlook.

GDP growth in the **Netherlands** is expected to remain robust in 2018. Private consumption remains strong as the labour market tightens and wage growth increases. Investment growth is expected to weaken somewhat in 2018 as residential investment growth declines. We expect a slight easing in the pace of decline in insolvencies to 12% in 2018 reaching 51% of its 2007 level. In 2019 GDP growth is expected to moderate to 1.5% and the level of insolvencies is expected to stagnate.

Germany's economy is expected to gradually lose momentum over the coming two years as foreign demand weakens. Private consumption and investment growth are however, forecast to remain strong. Private consumption is bolstered by employment growth and strengthening wages. Investment growth remains robust. The insolvency forecast for 2018 is a decrease of 4%, followed by stagnation in 2019.

GDP in **France** is forecast to expand 1.6% this year and remain at approximately this level next year. A reduction in social contributions and housing taxes along with wage increases and employment growth are likely to boost consumption. With unemployment decreasing and interest rates at low levels, we expect a 7% decline in the total number of insolvencies this year followed by a 5% decline in 2019.

In **Italy,** a government was formed by the populist Lega and M5S (Five Star Movement). This successful formation of a government should bode well for stability, but the administration is expected to prioritise stricter migration policies and take a more vocal stance in the EU. GDP growth is expected to shift into a lower gear compared to 2017, but remains broad-based. Insolvencies are expected to decline 4% in 2018, a less pronounced decline than in 2017. The total number of corporate bankruptcies in 2018 is still on track to be nearly twice as many as in 2007. In 2019 another 2% decline in insolvencies is forecast. Given the uncertainty about the fiscal agenda and reform, the insolvency forecast is subject to downward risk.

Spain is entering its fifth year of growth, with unemployment falling and industrial production growing. These indicators are all expected to remain solid, although not all the damage from the 2011-2013 crisis has been repaired and there is a long road ahead before insolvencies are back at 2007 levels. We forecast a 3% decrease in insolvencies in 2018 as well as in 2019.

The **Portuguese** economy is growing rather robustly and continued GDP growth is expected, as well as an improvement in unemployment. Industrial production growth is expected to decline in 2018 but should pick up again in 2019. Insolvencies in H1 of 2018 were down 20% from H2 of 2017, bringing our forecast for 2018 to a decline of 15%. In 2019 a decline of 5% is expected.

Finland and **Luxembourg** are exceptions to the generally positive eurozone outlook. In Finland, higher employment, disposable income and solid consumer confidence are expected to drive household consumption. High capacity utilisation and favourable financing conditions should support investment. Despite the strong GDP growth outlook, insolvencies are up 25% in H1 of 2018 compared to H2 of 2017, bringing our forecast for 2018 to an increase of 12%. In 2019, a much smaller increase of 3% is expected. Luxembourg is facing a projected 17% increase in insolvencies in 2018 before improvement of 6% in 2019. In H1 of 2018, corporate failures increased more than 30% compared to H1 of 2017, largely concentrated in the retail sector as consumer preferences shift to online outlets.

Divergent outlook for the rest of Europe

As the eurozone leads global improvements in the business environment again, other European markets are experiencing more difficulty. While economic growth across most of Western Europe remains strong, country-specific developments are causing business bankruptcies to tick up.

Denmark, **Norway** and, to a lesser extent, **Sweden** are following Finland in the trend of increasing insolvencies despite overall robust economic situations. Following disappointing H1 data, further challenges such as extreme weather conditions this summer could cause insolvencies to increase in the agricultural sector while also straining consumer spending due to the temporary increase in inflation.

Tepid economic growth and mounting Brexit-related uncertainty are contributing to increasing bankruptcies in the **United Kingdom**. While the UK economy has demonstrated resilience through 2016 and 2017, economic growth is set to ease to 1.3% in 2018 and 1.4% in 2019. The loss of momentum comes as business investment declines related to Brexit uncertainty and sterling strengthens, reversing the boost to competitiveness of UK exports. The collapse of construction giant, Carillion, earlier this year has translated into higher construction sector bankruptcies. Higher inflation coupled with weak wage growth has also weighed on private consumption as personal bankruptcies have reached a six-year high and consumers shift to more online shopping. This has also driven increases in the retail sector. Higher interest rates and a tight fiscal stance are expected to continue straining economic activity in the UK. As such, we project insolvencies to increase 6% in 2018 followed by another 3% increase in 2019. The baseline scenario is that the official exit from the EU next year is followed immediately by a transition arrangement. In the case that this agreement does not work out, and a hard Brexit takes place, the number of corporate failures in the UK would likely increase further.

US insolvencies decreasing sharply as headwinds increase

After a 4% decline in bankruptcies in 2017, momentum has continued to gather for US corporates, driving an upward revision of the 2018 outlook. Solid economic fundamentals have been stoked by tax reforms, driving up business confidence and driving down insolvencies. A strong expansion in GDP growth and decline in the number of insolvencies in H1 are driving a forecast 2.8% expansion in GDP and 8% decline in insolvencies. The current boom, however, is likely to be temporary.

In 2019, US GDP growth is forecast to ease to 2.2% as the effect of fiscal stimulus fades. Downside risks are increasingly weighing on the US outlook and could have negative implications for the corporate sector. A strengthening US dollar and potential trade barriers, even the associated uncertainty, strain exporters. Domestically, changing shopping patterns, especially the shift away from mall shopping, is already causing major bankruptcies for retailers – a pattern which is expected to persist in the coming years. Rising interest rates are increasingly making financing more expensive and acting as another headwind for US corporates. As such, bankruptcies are forecast to decrease only 2% in 2019.

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Table 1 Total insolvencies - annual percentage change

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018f	2019f
Australia	-4	18	3	-1	5	1	4	-22	10	-12	-7	-5	-4
Austria	-6	0	9	-8	-8	3	-10	-1	-5	1	-3	-4	2
Belgium	1	10	11	2	7	4	11	-9	-9	-6	9	-6	0
Canada	-10	-7	-2	-11	-9	-4	0	-1	3	3	-3	0	0
Denmark	-	-	-	-3	-22	4	-15	-21	15	18	-4	15	-4
Finland	-1	16	25	-13	3	0	6	-5	-14	-6	-10	12	3
France	7	7	14	-5	-1	3	3	0	0	-8	-5	-7	-5
Germany	-15	0	12	-2	-6	-6	-8	-7	-4	-7	-7	-4	0
Ireland	19	100	50	10	7	3	-19	-15	-10	-2	-15	-5	-5
Italy	-41	22	25	20	8	3	13	11	-6	-9	-11	-4	-2
Japan	6	11	-1	-14	-4	-5	-10	-10	-8	-6	0	-2	2
Luxembourg	-	19	17	32	8	8	1	-19	3	13	-5	17	-6
Netherlands	-13	-14	53	-9	0	19	10	-22	-24	-19	-22	-12	0
New Zealand	-5	-35	45	-5	-12	-7	-13	-7	4	3	-22	-6	-6
Norway	-6	41	47	-17	0	-13	18	6	-3	-1	4	9	0
Portugal	-	39	28	21	-5	46	1	-13	12	-6	-16	-15	-5
Spain	18	188	88	-4	15	32	10	-27	-21	-9	3	-3	-3
Sweden	-5	7	20	-4	-4	7	4	-6	-11	-5	6	1	-4
Switzerland	-	-7	24	20	-22	41	-5	-10	4	7	3	2	0
United Kingdom	-10	35	14	-18	4	-4	-9	-8	-10	0	0	6	3
United States	42	52	41	-7	-15	-16	-17	-19	-8	-2	-4	-8	-2

Sources: Atradius, Macrobond, national sources

Table 2 Total insolvencies - index, 2007 = 100

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018f	2019f
Australia	100	118	121	120	126	127	133	104	115	101	94	90	86
Austria	100	100	110	101	93	96	87	86	82	83	81	77	79
Belgium	100	110	123	125	133	138	153	140	127	119	130	122	122
Canada	100	93	91	81	74	71	71	71	73	75	73	73	73
Denmark	-	-	100	97	76	78	67	53	60	71	68	78	75
Finland	100	116	145	127	131	131	139	132	114	107	96	107	111
France	100	107	123	117	115	118	122	121	122	112	106	99	94
Germany	100	100	112	110	103	97	89	83	79	74	69	66	66
Ireland	100	200	300	330	354	364	295	252	227	223	189	180	171
Italy	100	122	152	182	197	203	229	254	239	219	195	187	183
Japan	100	111	110	95	90	86	77	69	64	60	60	58	60
Luxembourg	100	119	139	183	197	213	215	175	180	204	194	227	213
Netherlands	100	86	132	119	120	143	157	122	92	75	58	51	51
New Zealand	100	65	95	89	79	73	64	59	61	63	49	46	43
Norway	100	141	207	171	172	150	176	186	180	179	187	204	204
Portugal	100	139	179	216	205	300	303	262	294	277	233	198	188
Spain	100	288	540	520	598	791	866	635	501	458	473	459	445
Sweden	100	107	128	123	118	126	130	122	108	103	109	110	106
Switzerland	100	93	115	138	107	151	143	130	135	144	148	151	151
United Kingdom	100	135	153	125	130	124	113	104	93	93	93	99	102
United States	100	152	215	199	169	142	118	95	88	85	82	76	74

Sources: Atradius, Macrobond, national sources