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2021: A turn of the tide in insolvencies

Atradius Economic Research – March 2021

Summary

- Corporate insolvencies continued to decrease in 2020, despite the sharp decline in GDP. This discrepancy is driven by temporary adjustments to insolvency laws and fiscal support packages.
- As support measures are phased out, global corporate insolvencies are forecast to increase by 26% in 2021.
- The percentage increase of insolvencies in 2021 is highest in Australia, France, Singapore and Austria, all countries that had strong government measures in place in 2020. As these measures will be gradually phased out, this will drive insolvencies up.

The widely anticipated rise of business insolvencies did not occur in 2020. Global insolvencies are estimated to have declined by 14% in 2020. This is likely to be followed by a 26% rise of insolvencies in 2021. The increase is expected to take place in all major regions and countries, except Turkey. This upward trend is not surprising, as we expect that the temporary measures that kept insolvencies unusually low in 2020 (insolvency law amendments, fiscal support) are gradually phased out in 2021. The level of bankruptcies at the end of 2021 will be higher in virtually all markets than it was in 2019.

The pace of economic recovery in 2021 varies significantly around the world

After a year of global recession, 2021 is bringing new hope as the recovery will set in. Global GDP growth is estimated at 6.0% in 2021, after a 3.7% contraction in 2020. The rollout of vaccines is underway, and positive trial results should boost vaccine availability as the year progresses. While global growth in Q1 of 2021 is likely to remain modest due to activity restrictions in order to bring Covid-19 numbers down, an acceleration of GDP will take place in the rest of the year.

However, there are still risks to this outlook, mainly linked to the evolution of the pandemic and the success of vaccination campaigns. New Covid-19 infection cases remain high in some countries, such as Brazil, France, Italy and Turkey. While vaccination has started almost everywhere in the developed world, the pace has to accelerate in order to get a substantial part of the population vaccinated by the end of Q2. In this respect Israel is ahead of other countries, already experiencing a substantial drop in new Covid-19 cases and tangible reductions in hospitalisations. The UK and the US are also doing better than average. In Europe the rollout is still slow in many countries and needs to accelerate in order to get a substantial of the population vaccinated by summer.

The pace of GDP recovery in 2021 varies significantly around the world. The eurozone witnessed a 6.8% GDP contraction in 2020, but with a moderate 0.7% quarter-on-quarter GDP decline in Q4 it coped better than expected with re-imposed Covid-19 restrictions. While it is likely that ongoing lockdowns and the slow start of the vaccination rollout will lead to a double dip recession in Q1 of 2021, there is light at the end of the tunnel. As vaccination programmes gain momentum and the pressure on health systems subsides, containment measures are set to relax gradually. This should lead to an economic recovery as of Q2, bringing Eurozone GDP growth to 4.2% in 2021. Countries that experienced the deepest recessions in 2020 will generally witness the strongest expansion in 2021. Several factors determine the strength of the economic recovery. First, the stringency of lockdown measures and the speed at which they can be reversed. Last year´s lockdown measures were relatively stringent in Portugal, Italy, Spain and Ireland, which led to low consumption of services in those countries. In comparison, less stringent measures could be found in the Netherlands, Austria and Finland (although in the Netherlands measures were tightened considerably towards the end of 2020). The reversal of containment measures will cause a 'technical recovery' in 2021. Countries like Spain, France and Italy can expect relatively high economic growth figures in 2021, while the rebound in the Netherlands and Austria will be lower.

Second, the sectoral composition is also affecting the strength of GDP growth. Due to the importance of tourism for their economies, Portugal, Spain, Greece, Italy and France recorded a strong negative impact on GDP in 2020. As restrictions on tourism and travel are gradually lifted, demand for those services will increase, helping the recovery in those countries. However, tourism flows will not fully recover in 2021, as some people will refrain from travelling to limit health risks. Additionally governments could be reluctant in opening their borders, given that the pace of vaccination differs per country.

The United Kingdom experienced a deep recession in 2020 (-9.9% GDP) due to strict lockdown measures and Brexit uncertainty. In January 2021 the British government imposed a third nationwide lockdown in response to the steep rise in Covid-19 cases associated with the more transmissible variant of the virus. This has placed the economy on a weak footing at the beginning of 2021. The good news is that the UK and the EU finally agreed on a free-trade agreement, limiting the cost of exiting the common market compared to a no-deal. In 2021 we forecast the UK economy to expand 5.9%, which covers only about half of the GDP losses from the pandemic. We expect a meaningful relaxation of lockdown measures as of Q2, as the vaccination programme is well underway.

Outside of Europe, the United States is expecting a strong economic recovery of 7.0% in 2021, a 3 percentage point upward revision compared to our September 2020 insolvency forecast report. The 7.0% growth rate will more than compensate the economic losses seen in 2020. President Joe Biden recently signed a major fiscal stimulus package, the American Rescue Plan, which amounts to USD 1.9 trillion (8.3% of the total US economy). Moreover, at the current pace of vaccination rollout the US will reach herd immunity (70% of the adult population inoculated) by early summer. This will ease virus fears and allow for a relaxation of activity restrictions, supporting the economic recovery.

Australia ranks among the best performing developed countries, having the virus effectively under control. Perth's five-day lockdown in January in response to the detection of one case demonstrates the government's responsiveness. Australia recorded a relatively mild recession (-2.4%) in 2020, likely to be followed by a 3.5% GDP expansion in 2021.

Japan experienced a 4.9% GDP contraction in 2020, likely to be followed by a partial recovery of 2.7% in 2021. The country experienced a rise of infections towards the end of 2020, triggering a state of emergency. Meanwhile this measure has been lifted for most of the country, except of Tokyo and three neighbouring prefectures, which will remain under restrictions until end-March. While these restrictions will affect the rebound the overall impact will be mild, as the vaccine rollout and stronger growth in the US and China will support economic activity from mid-year onward.

Discrepancy between insolvency development and GDP performance in 2020

The widely anticipated surge in business insolvencies did not occur in 2020. For most markets the almost complete full-year bankruptcy data is available, which generally points to decreases compared to 2019. Global insolvencies are estimated to have declined by 14% in 2020, with strong decreases in Europe and Asia in particular, and somewhat smaller declines in North America (see chart 1).

Chart 1 Insolvency outlook 2020

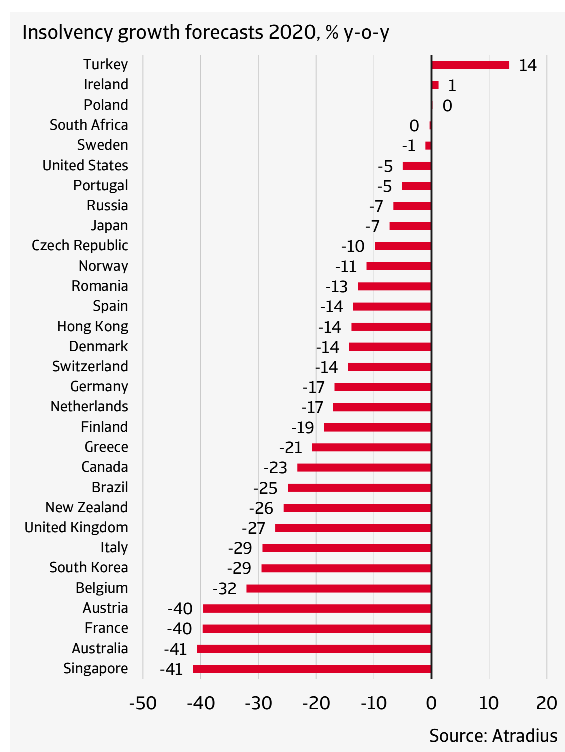
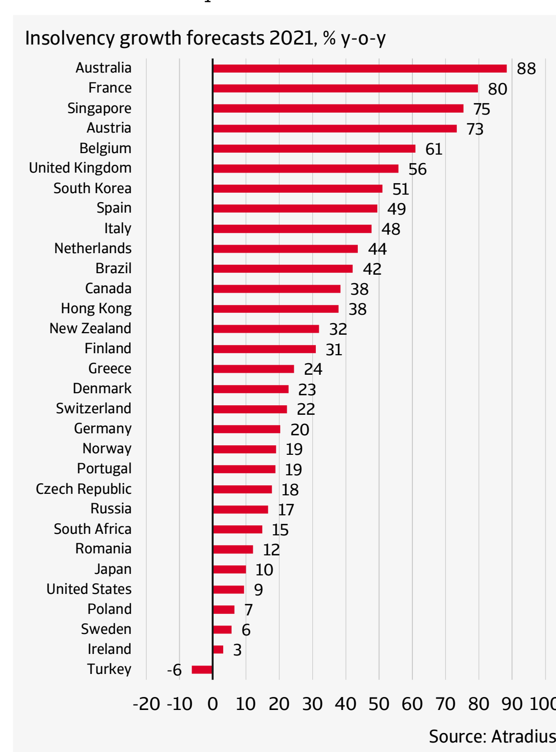


Chart 2 Insolvency outlook 2021



In our previous insolvency report we argued that two types of policies are responsible for the discrepancy between insolvency development and GDP performance. 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 counteract the 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 freeze bankruptcy proceedings or declare 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.

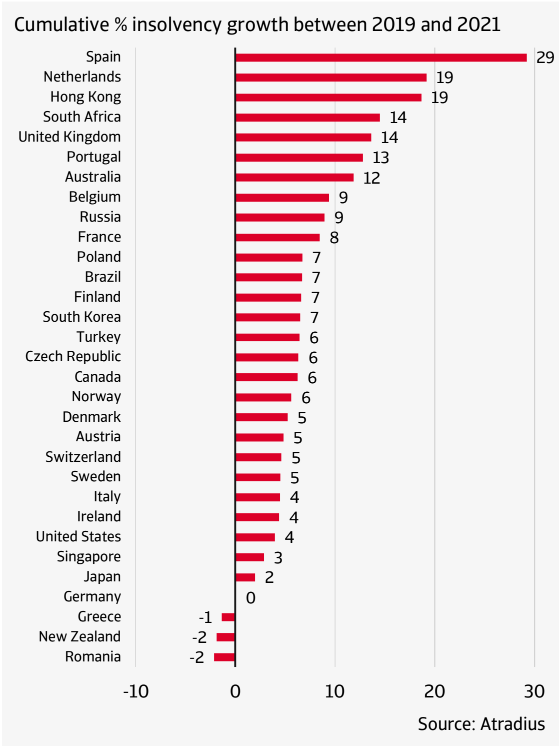
Countries with less sharp decreases in insolvencies often made lesser or no changes to insolvency laws in order to cope with Covid-19, such as Sweden, Denmark, the Netherlands, Ireland, Japan and the United States. Since November 2020 the Netherlands has a temporary law in place under which companies in distress can apply for a temporary suspension of insolvency proceedings and a payments moratorium.

Besides insolvency law changes, fiscal support measures also play a crucial role in keeping insolvency levels low. This assumption is supported by the observation that in some countries with temporary bankruptcy moratoriums the levels of insolvencies remained low even after the moratorium was lifted (e.g. France and Switzerland). Moreover, in Spain bankruptcies showed a steep quarter-on-quarter increase in the last half of 2020 although the insolvency moratorium was still in place. The most effective form of government measures are direct fiscal spending and tax breaks (classified by the IMF as 'above the line' fiscal measures, in contrast to 'below the line' measures, such as loans or equity injections). European countries with extensive fiscal support measures are Germany, France, Austria, Belgium, the Netherlands, and the UK. Outside of Europe, the United States, Canada, Australia, and Japan have all implemented substantial fiscal support packages, contributing to very low insolvency levels in 2020 compared to GDP contraction. Turkey and Ireland are the only observed markets with an increase in insolvencies in 2020. For Turkey, this is clearly the result of weaker government support, while in Ireland no adjustments to the insolvency framework were made in relation to Covid-19.

Business insolvencies expected to increase 26% globally

In 2021 the picture of declining insolvencies will completely turn around, as we expect that fiscal measures and insolvency law amendments will be gradually unwounded. This will push global insolvency growth to 26% in 2021, with increases

Figure 3 Cumulative insolvency growth 2021/2019

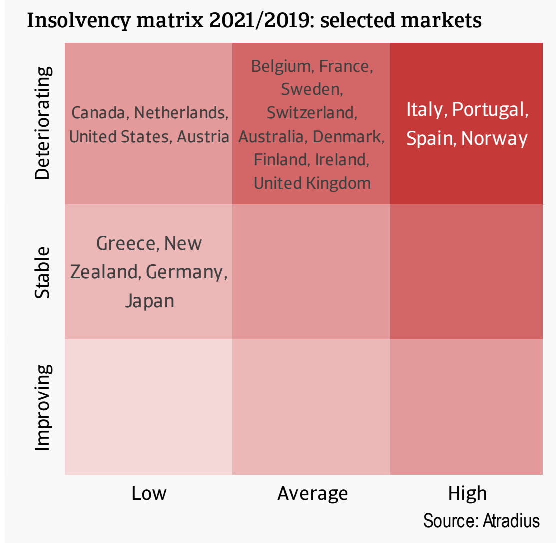


across all major regions and countries (see chart 2). Bankruptcy moratoriums are expected to expire in the first half of 2021. In Austria and Finland the suspension of normal bankruptcy rules expire in Q1 of 2021, while Australia returned to normal bankruptcy procedures on 1 January 2021. The Netherlands extended its moratorium until April 2021. In several countries, fiscal stimulus packages are currently being extended until Q2 2021. After Q2 2021, a more significant relaxation of containment measures is expected, resulting in a phasing out of fiscal support and a lifting of bankruptcy moratoriums.

Three forces shape the 2021 insolvency forecast

A first force shaping the insolvency forecast is the delayed effect of bankruptcies that under normal circumstances (no fiscal package, no insolvency moratoriums) would have occurred in 2020. We assume that parts of those bankruptcies will materialise in 2021. Countries that 'saved' many firms from bankruptcy in 2020 will see a relatively strong carry-over of bankruptcies into 2021, upwardly affecting the insolvency forecast for 2021. This is expected to happen in a number of markets that provided temporary adjustments to insolvency law and extensive fiscal support, such as Belgium, France, Austria and Italy.

Figure 4 Insolvency matrix 2021/2019



Outside Europe Australia and Singapore are examples, as in those markets there is a delay of insolvencies from last year to this year. For Sweden and Ireland we expect a lower effect of delayed insolvencies from 2020, as in both countries there have been no major changes to the insolvency laws.

A second force is the increase in insolvencies due to economic conditions, which depends two factors: the strength of economic growth in 2021, and how responsive insolvencies are to GDP growth. In some markets (Austria, Spain, United Kingdom), the recovery is weak compared to the 2020 contraction, which leads to upward pressure on insolvencies. In other markets the recovery in 2021 is relatively strong (New Zealand, Canada), generating a downward pressure on insolvency growth. Regarding sensitivity of insolvencies to GDP growth, this 'elasticity' is high for instance in the Netherlands, Spain and Australia. As a consequence, we see a rather strong cumulative increase of insolvencies in between 2019 and 2021. The high elasticity of insolvencies to GDP growth in the three markets is the result of the rigidity of the bankruptcy laws, which are very creditor friendly. However, Spain has implemented some reforms in 2014 that incentivize companies experiencing difficulties to opt for restructuring instead of liquidation. Both the Netherlands and Australia have reformed their bankruptcy laws in 2020. In the Netherlands, a new bankruptcy law will make it easier to restructure a company outside a formal bankruptcy procedure, and Australia implemented reforms that try to achieve the same. Both Australia and the Netherlands draw inspiration from US Chapter 11 insolvency framework (with the Netherlands additionally from the English scheme of arrangements). This could change the elasticity of bankruptcies to GDP

growth in the future. The same could to some extent apply to Spain, but there the reforms have been less fundamental.

As a third force shaping the 2021 insolvency forecast, fiscal support matters. We expect government support schemes to be continued in the first half of 2021, but quickly phased out in the second half, when a large part of the population in developed markets is vaccinated. We therefore assume that fiscal measures will apply to roughly the first half the year only.

On balance, these three forces translate in a year-on-year insolvency rise in 2021 in all markets, except for Turkey. Turkey already recorded an increase in bankruptcies in 2020, meaning there is little carry-over of bankruptcies into 2021, and fiscal support has been weak. What plays a role in explaining the strong increases in bankruptcies in 2021 is that the level of insolvencies was particularly low in 2020, due to temporary insolvency freezes and fiscal support packages.

This creates a strong upward 'base effect'. Looking at the cumulative insolvency growth between 2019 and 2021, the level of bankruptcies at the end of 2021 will be higher in virtually all markets than it was in 2019 (see chart 3). This is not surprising, given the strong economic contraction in 2020 and the incomplete recovery in most countries in 2021. For the coming years, we expect that the level of bankruptcies will remain elevated. The phasing out of fiscal support packages and the return to normal insolvency procedures continue to make the business environment very challenging.

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Table 1 Total insolvencies - annual percentage change

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020f	2021f
Australia	-3	21	4	2	9	1	2	-19	16	-16	-8	3	3	-41	88
Austria	-6	0	9	-8	-8	3	-10	-1	-5	1	-3	-2	1	-40	73
Belgium	1	10	11	2	7	4	11	-9	-9	-6	9	-1	7	-32	61
Brazil	-25	-34	-6	-19	-12	7	8	-1	12	-13	29	0	-1	-25	42
Canada	10	-2	-41	-11	13	-11	-2	-2	-1	-7	-6	-1	3	-23	38
Czech Republic	-	-	-	-	-	-	-	-	188	-10	-15	-16	4	-10	18
Denmark	21	54	-10	-3	-22	4	-15	-21	15	18	-4	7	6	-14	23
Finland	-1	16	25	-13	3	0	6	-5	-14	-6	-10	17	3	-19	31
France	7	7	14	-5	-1	3	3	0	0	-8	-6	-1	-5	-40	80
Germany	-15	0	12	-2	-6	-6	-8	-7	-4	-7	-7	-4	-3	-17	20
Greece	-3	-35	68	-35	-4	19	31	-16	-43	-43	14	-32	27	-21	24
Hong Kong	7	-3	50	-43	-13	2	15	3	1	-9	-14	-6	9	-14	38
Ireland	19	113	82	8	7	3	-19	-15	-10	-2	-15	-13	-25	1	3
Italy	-41	22	25	20	8	3	13	11	-6	-9	-11	-7	-1	-29	48
Japan	6	11	-1	-14	-4	-5	-10	-10	-8	-6	0	-2	2	-7	10
Netherlands	-13	-14	53	-9	0	19	10	-22	-24	-19	-22	-9	4	-17	44
New Zealand	-5	-35	45	-5	-12	-7	-13	-7	4	3	-22	-7	-18	-26	32
Norway	-6	41	47	-17	0	-13	18	6	-3	-1	4	12	3	-11	19
Poland	-	-	-	-	4	24	1	-9	-7	-19	-2	4	-5	0	7
Portugal	-12	39	28	21	-5	46	1	-13	12	-6	-16	-4	-8	-5	19
Romania	-	-	-	-	-9	36	10	-30	-50	-18	9	-9	-21	-13	12
Russia	0	14	80	8	-18	-6	9	18	1	-3	10	-4	-6	-7	17
Singapore	-7	-16	-12	-25	-1	14	14	-12	1	1	-9	1	-1	-41	75
South Africa	4	5	25	-3	-11	-24	-13	-13	-5	-1	-3	-1	11	0	15
South Korea	-9	19	-27	-21	-13	-10	-18	-16	-14	-23	-11	-5	-12	-29	51
Spain	18	188	88	-4	15	32	10	-27	-21	-9	10	11	21	-14	49
Sweden	-5	7	20	-4	-4	7	4	-6	-11	-5	6	13	2	-1	6
Switzerland	-	-7	24	20	6	3	-5	-10	4	7	3	3	-1	-14	22
Turkey	-	-	-	-	12	7	8	-9	-13	-10	19	-8	3	14	-6
United Kingdom	-11	35	14	-18	4	-4	-9	-8	-10	1	-1	10	7	-27	56
United States	42	52	41	-7	-15	-16	-17	-19	-8	-2	-4	-4	3	-5	9

Sources: Atradius, Macrobond, national sources

Table 2 Total insolvencies - index, 2007 = 100

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020f	2021f
Australia	100	121	125	128	139	141	144	117	135	113	104	107	111	66	124
Austria	100	100	110	101	93	96	87	86	82	83	81	79	80	48	84
Belgium	100	110	123	125	133	138	153	140	127	119	130	129	138	94	151
Brazil	100	66	61	49	43	47	50	50	56	49	63	63	62	47	66
Canada	100	98	58	51	58	51	51	50	49	46	43	43	44	33	46
Czech Republic	-	-	-	-	-	-	-	100	288	260	221	186	195	176	207
Denmark	100	154	139	134	105	109	93	73	84	98	95	101	108	93	114
Finland	100	116	145	127	131	131	139	132	114	107	96	112	116	94	123
France	100	107	123	117	115	118	122	121	122	112	106	105	100	60	108
Germany	100	100	112	110	103	97	89	83	79	74	69	66	64	53	64
Greece	100	65	109	71	68	81	106	89	51	29	33	23	29	23	29
Hong Kong	100	97	146	83	72	74	85	87	88	81	69	65	70	60	83
Ireland	100	213	387	420	451	464	376	321	289	284	241	209	156	158	163
Italy	100	122	152	182	197	203	229	254	239	219	195	181	180	127	188
Japan	100	111	110	95	90	86	77	69	64	60	60	58	59	55	61
Netherlands	100	86	132	119	120	143	157	122	92	75	58	53	55	46	66
New Zealand	100	65	95	89	79	73	64	59	61	63	49	46	38	28	37
Norway	100	141	207	171	172	150	176	186	180	179	187	211	217	193	229
Poland	-	-	-	100	104	129	130	119	110	89	87	90	86	86	92
Portugal	100	139	179	216	205	300	303	262	294	277	233	224	207	197	234
Romania	-	-	-	100	91	124	136	95	47	39	42	38	30	26	29
Russia	100	114	205	222	183	173	188	222	223	217	238	229	215	201	234
Singapore	100	84	74	56	55	63	72	64	64	65	59	60	59	35	61
South Africa	100	105	131	127	113	86	75	66	62	61	59	59	65	65	74
South Korea	100	119	87	68	59	54	44	37	31	24	22	20	18	13	19
Spain	100	288	540	520	598	791	866	635	501	458	502	558	678	586	876
Sweden	100	107	128	123	118	126	130	122	108	103	109	124	126	125	132
Switzerland	100	93	115	138	147	151	143	130	135	144	148	152	151	129	158
Turkey	-	-	-	100	112	119	129	118	102	92	109	101	105	119	111
United Kingdom	100	135	153	125	130	124	113	104	93	94	93	103	110	80	125
United States	100	152	215	199	169	142	118	95	88	85	82	79	81	77	84

Sources: Atradius, Macrobond, national sources

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