ECO FLASH

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INCREASE IN BUSINESS INSOLVENCIES IN EUROPE: SHOULD WE BE WORRIED?

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In Western Europe, in Q4 2022, the number of business insolvencies returned to levels close to those seen at the end of 2019.

This increase conceals national disparities. The United Kingdom and Sweden saw it earlier, as weakening growth and tightening of monetary policy occurred earlier in these countries (and more significantly for the United Kingdom) than in the eurozone. In the eurozone, the increase in insolvencies remains partial, but is likely to continue.

The situation in the various sectors reflects these differences. As a result, the increase is almost across all sectors in the United Kingdom and Sweden, particularly in construction and even more so in trade.

In France, business insolvencies are approaching their pre-Covid levels but are still 6.1% lower in Q1 2023. However, this still relatively favourable situation is concealing the risk of a more pronounced impact of these insolvencies on the economy and employment. Indeed, the large companies' insolvencies and the proportion of compulsory liquidations have both increased.

WESTERN EUROPE: INSOLVENCIES INDEX

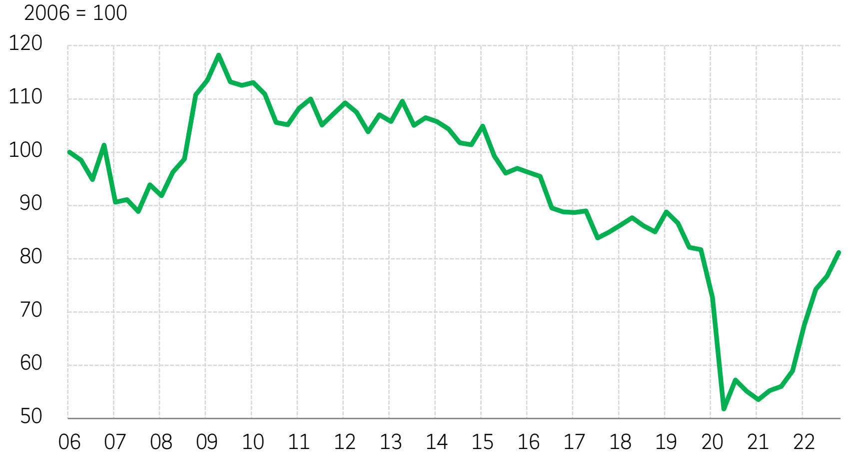

CHART 1

SOURCE: NATIONAL SOURCES, BNP PARIBAS CALCULATIONS

The number of business insolvencies (see box) is a variable used to assess the consequences of recent shocks (energy prices, rising interest rates) on the financial situation of companies, in particular the risk that, becoming insolvent, their payment behaviour will deteriorate.

In Europe[1], budgetary policies implemented during the Covid-19 pandemic reduced the number of insolvencies. Withdrawal of these support measures, followed by the consequent tightening of monetary policy, which began a year ago against a backdrop of inflationary shocks and rising energy prices, led to an increase in insolvencies at the end of last year, albeit from a particularly low starting point (Chart 1[2]). At the end of 2022, the insolvencies' index returned to a level last seen at the end of 2019.

This analysis aims to review these developments and identify countries and sectors where they are most pronounced. We should also expect this increase in insolvencies to continue. In fact, several factors seem worse than at the end of 2019: the level of interest rates, inflation along with the real estate market in several of the countries included in the analysis.

COUNTRIES: CLEAR DIFFERENCES

An assessment of the dynamics of business insolvencies in each country shows quite clear differences (Chart 2[3]). The United Kingdom and Sweden have already seen their numbers exceed levels recorded at the end of 2019, attributable, at least in part, to an earlier drop in growth in these two countries, seen from early 2022, whereas growth in the eurozone mainly

1This study covers Germany, France, Italy, UK, Belgium, Netherlands, Sweden. Spain is not included in the study due to the easing of rules on access to court-ordered insolvency procedures, implemented in 2022, which complicates the comparison of long-term statistics.
2 The index shows a GDP weighted average which we have calculated.
3 Italy is not shown in this Figure as the data stop in Q1 2022.

ECONOMIC RESEARCH

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INSOLVENCIES CHANGE COMPARED TO 2019 LEVEL

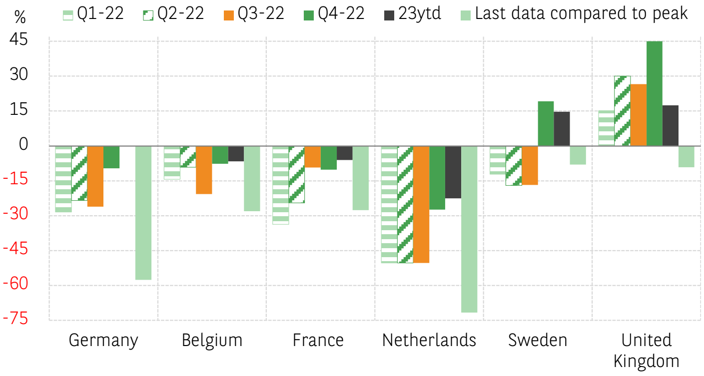

CHART 2

SOURCE: NATIONAL SOURCES, BNP PARIBAS CALCULATIONS

fell in the last quarter of last year. Both countries have also suffered double-digit inflation peaks (11.1% YoY in October and 12.3% YoY in December, respectively). And this explains why the tightening of monetary policy came earlier in these countries than in the eurozone, and for the United Kingdom, this tightening was even more pronounced.

In eurozone countries, the rise in business insolvencies is less significant, which can be partly attributed to a later tightening of credit. According to the ECB euro area bank lending survey, the tightening of lending criteria was more marked from October 2022 onwards.

In late 2022 or early 2023, countries experienced a fairly similar increase in the number of insolvencies (Chart 2), which suggests a common cause, both in terms of the economy and monetary momentum. However, these drivers are likely to deteriorate. In fact, the ECB has not yet completely finished with interest rate hikes (a further +50 basis points according to our scenario, for a deposit rate at 3.50%). Moreover, the next few quarters should remain marked by low growth, close to that seen in Q4 (zero growth), or even slightly negative.

SECTORS: AREAS OF CONCERN

Idiosyncratic factors may aggravate the increase in business insolvencies, especially when specific sector's triggers are observed.

Construction and trade are the sectors that generally experience the most business insolvencies, as they are among the most sensitive to the economic climate and bring together many smaller, more vulnerable companies. In construction, factors affecting demand (i.e., contraction in demand for housing) and supply (increase in costs, contraction in margins) may be at work. This sector is also very sensitive to a rise in interest rates, which directly affects demand. Retail trade meanwhile, is very exposed to changes in household consumption and also to the level and dynamics of inflation, a general context that impacts margins.

The United Kingdom and Sweden are experiencing a more marked deterioration (Chart 3[4]), particularly in trade. In the United Kingdom, insolvencies in this sector were even higher by almost 16% than the

4 The data stop at December 2022 for Germany, March 2023 for France and February 2023 for other countries.

WHAT IS A "BUSINESS INSOLVENCY"?

Business insolvencies relate to court-ordered insolvency proceedings to which companies in difficulty are subject. There are three types of proceedings: the most common are liquidation, which involves cessation of activity, and "administration", which may give rise to a partial recovery plan. A third type of proceedings, "safeguard proceedings", often initiated at the initiative of the company concerned, helps deal with difficulties upstream (it may lead to asset disposals, but with less impact on jobs), but it is much less used.

INSOLVENCIES: CHANGE BETWEEN LAST 6 MONTHS AND THE SAME PERIOD PRE-COVID

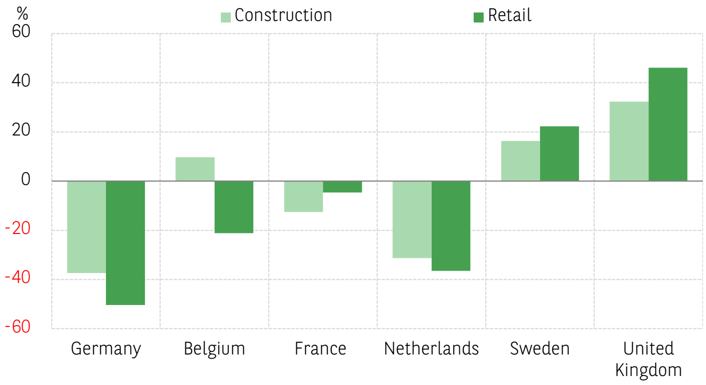

CHART 3

SOURCE: NATIONAL SOURCES, BNP PARIBAS CALCULATIONS

INSOLVENCIES: CHANGE BETWEEN LAST 6 MONTHS AND THE SAME PERIOD PRE-COVID

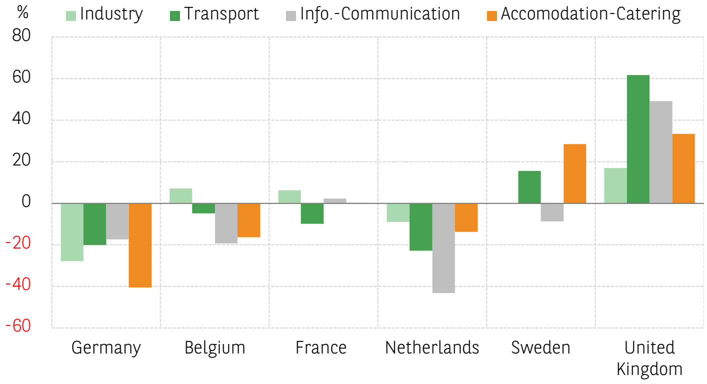

CHART 4

SOURCE: NATIONAL SOURCES, BNP PARIBAS CALCULATIONS previous record high seen in 2012, confirming that such high inflation had not been seen for 40 years, while construction sector defaults remained 2.3% below levels reached in H1 2010.

In the other countries, the situation is not as deteriorated, with two exceptions: France, in the trade sector (see next section), and Belgium, where the construction sector is more exposed to defaults.

The dynamics observed in the other sectors (Chart 4[5]) are consistent with the differences observed between countries, namely a downturn concentrated primarily in the United Kingdom and Sweden. However, industry stands out, with an increase to above pre-Covid levels already seen in Belgium and France.

FOCUS ON FRANCE: RISKS BELOW THE SURFACE?

In France, the number of business insolvencies remains below pre-Covid levels: nearly 45,000 units cumulatively over 12 months at the end of March 2023 (Chart 5). The increase is expected to continue in the coming months. In fact H1 2022 continued to show historically high cash levels as a result of the "whatever it takes" approach. Subsequently, the various shocks (energy, rising interest rates) caused a downturn in cash, with an increase in business insolvencies from H2 2022 onwards.

Over Q1 2023, the number of insolvencies remained 6.1% lower compared to the same period in 2019. However, the gap is narrowing rapidly and there are areas of concern, firstly, sector-based, with more marked increases in numbers of insolvencies in industry and in accommodation and catering.

In two sectors - trade and construction - which are structurally the most prone to insolvency, the increase remains partial, although it is more significant in trade. This sector has been suffering for a year now from the impact of high inflation on household consumption. Construction, on the other hand, continues to benefit from a quite favourable payment behaviour and from a volume of business from companies which has only started to see a downturn relatively recently. The impact on the number of insolvencies is still limited: this number remains almost half as low as in the period 2011-15, when the sector had accumulated almost 16,000 insolvencies per year. Falling demand, now noticeable in new housing, could change this situation, although this is not visible for the time being.

Two other areas of concern are emerging:

- Severity risk, i.e., the fact that insolvencies relate to higher volumes of turnover (or jobs or lending). As a result, the level of insolvencies of large and medium-sized companies is higher than in 2019 (39 compared to 26).
- Severity risk is in fact increased if the insolvency takes the form of compulsory liquidation rather than administration. Liquidation actually means the disappearance of the entity, while administration may generate a continuation plan (with a drop in workforce). In fact, the data from commercial court clerks suggest an increase in the proportion of liquidations in 2022 and early 2023 (Chart 6[6]).

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FRANCE: BUSINESS INSOLVENCIES (12-MONTHS SUM)

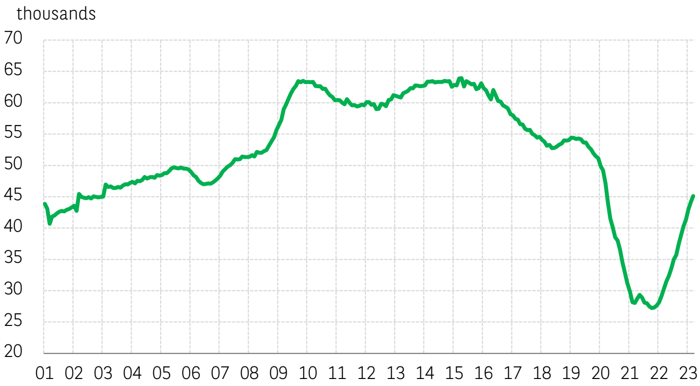

CHART 5 SOURCE : BANQUE DE FRANCE

FRANCE: PROPORTION OF LIQUIDATIONS IN TOTAL INSOLVENCIES

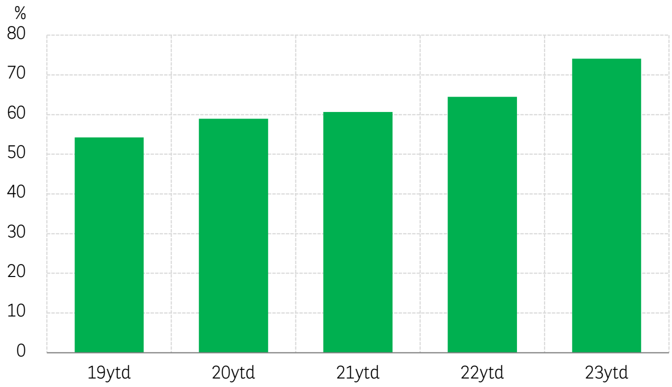

CHART 6 SOURCES: NATIONAL COUNCIL OF THE CLERKS OF COMMERCIAL COURTS, BNP PARIBAS CALCULATIONS

5 The data stop at December 2022 for Germany, March 2023 for France and February 2023 for other countries. The Swedish nomenclature does not feature the "industry" item.
6 In addition, these data also show a higher number of business closures which could be explained in 2022 by the disappearance of companies created during the Covid period to respond to a temporary increase in demand (particularly regarding home delivery). Business closures persist at a high level over the first few months of 2023.

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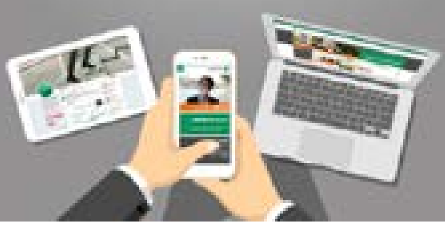

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