Economic Research

INSOLVENCIES

February 2018

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FEWER CASES, BIGGER CRASHES

Insolvencies Decline, Major Failures Rise

EULER HERMES

A company of Allianz

EXECUTIVE SUMMARY

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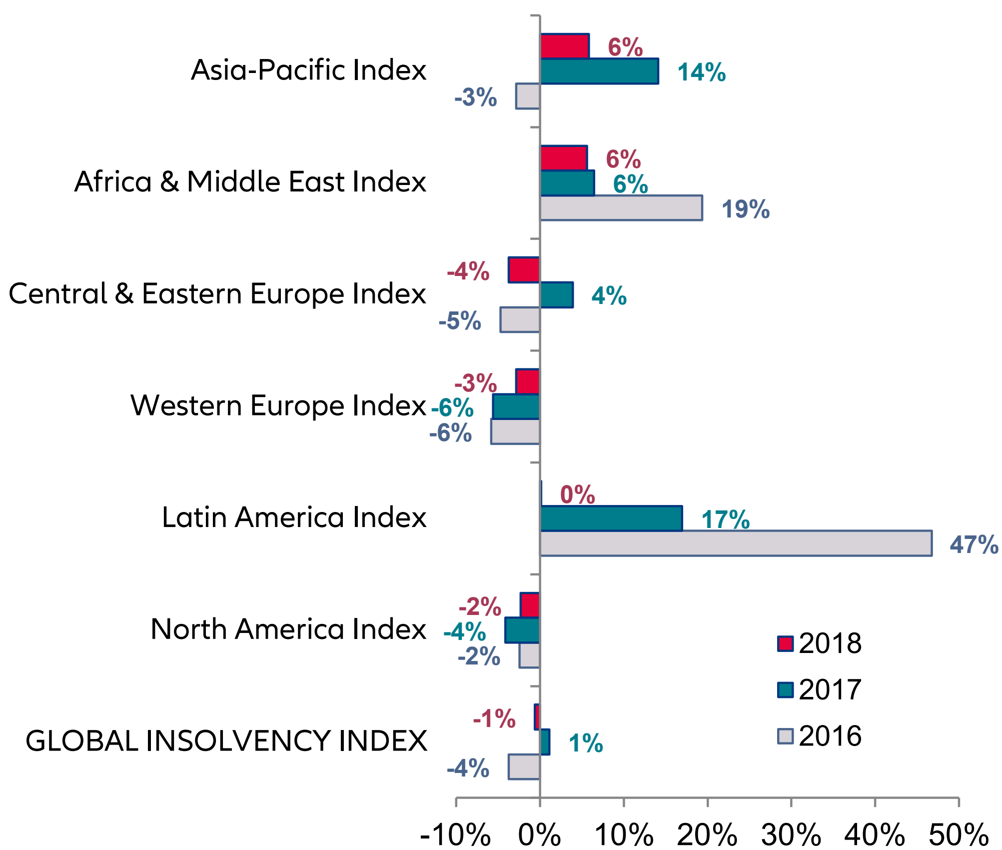
- At a global level, the downward trend in business insolvencies paused in 2017 (+1%). This was due to a rebound in Asia and on-going difficulties in emerging markets (Russia, Brazil).
- In 2018, the improved momentum should benefit companies (-1%). Thus, insolvencies are set to decrease -or stabilize- in a majority of countries. North America and other advanced economies will be key examples of this trend.
- Yet insolvencies will remain above their 2007 level in nearly 1 out of 2 countries, particularly in Europe.,
- While the frequency of insolvencies is set to diminish in 2018, this will not benefit companies equally. Figures on major insolvencies- of companies with a turnover above EUR 50 million - proves that major failures increased every quarter in 2017.
- The total number for the year was up by a staggering 57 cases to 321 companies representing a cumulative turnover of EUR104bn. This is a sharp rise to the tune of +EUR10bn compared to 2016.

Chart 1 Euler Hermes Global Insolvency Index and regional indices (yearly change in %)



Sources: National Statistics, Euler Hermes

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Global Insolvency Index
Euler Hermes 2018 forecast

-1%

GLOBAL FORECAST LESS CASES, REGIONAL DISPARITIES

- **Globally, a +1% rise in 2017, mainly due to a rebound in Asia and ongoing difficulties in Russia and Brazil**
- **In 2018, the improved economic momentum should benefit companies. Failures are set to decline -1% globally. Notable improvements in North America and advanced economies**
- **The UK with a +8% hike forecast for 2018 is a negative exception in Western Europe**

Global decline in insolvencies amid regional divergence

After seven consecutive years of substantial declines in worldwide insolvencies the improvement halted in 2017 (+1%).

This key forecast is based on the latest estimates of the Euler Hermes Global Insolvency Index. The index covers 43 countries totaling 83% of global GDP.

In 2018, failures should post a moderate decrease (-1%). This would be supported by the economic momentum but limited by the return of cost pressures and monetary tightening. Insolvencies will thus remain -4.5% below pre-crisis level (2003-2007 average).

Yet, this overall picture is driven by four disparate regional trends, in themselves driven by the largest countries.

Western Europe: The British exception

In Western Europe, the economic recovery and the supportive monetary conditions will continue to drive down the number of insolvencies (-3% after -6% in 2017), for the 5th consecutive year.

Yet they will remain above pre-crisis levels in 1 out of 2 countries. The sharpest declines should occur in countries that were still registering a high level of insolvencies in 2017 (compare to pre-crisis level), such as Italy (-10% in 2018), France (-7%), Portugal (-7%), Ireland (-4%) and Norway (-3%).

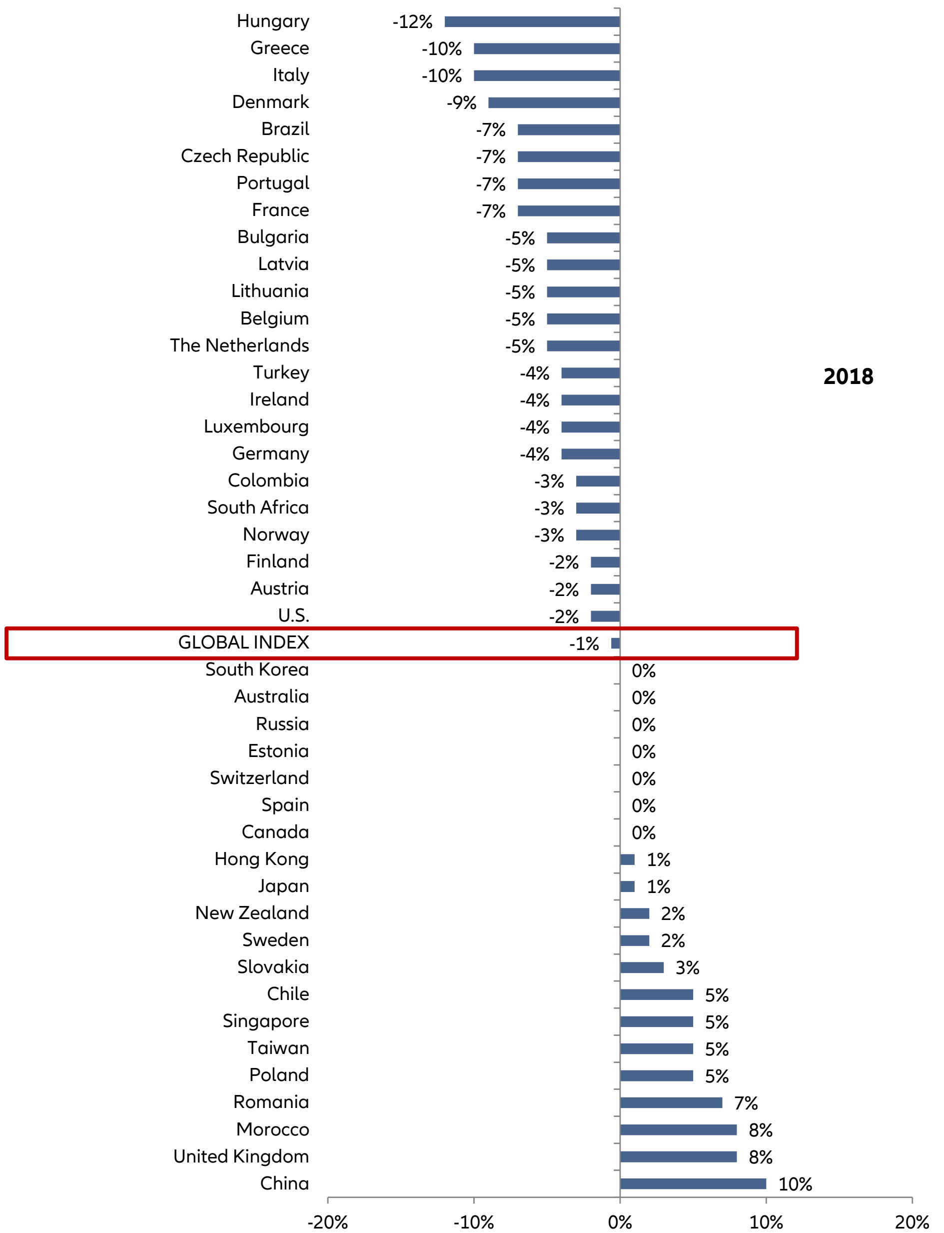
Countries with an already low volume of insolvencies at the end of 2017 should register a slower decline in 2018. This is the case for the Netherlands (-5%), Germany (-4%), Austria (-2%) and Finland (-2%). In Belgium (-5%), the rebound seen in 2017 was a one-off. It was driven to a large extent by insolvencies in Brussels, notably in the Hospitality and Restaurants industry, following the terror attacks.

The UK will be the main exception with a sizable increase (+8%) due to Brexit uncertainties.

US: Back to pre-crisis levels

After eight years of a steady fall, we anticipate a slower decrease in insolvencies in North America in 2018 (-2%). Insolvencies should plateau in Canada after reaching a record low in 2017. The US has a robust economic outlook for 2018, bolstered by the expected fiscal easing. This should support another decrease in insolvencies (-2%) to the lowest since 2006. Yet the improvement will be tempered by the gradual tightening of interest rates, input and labor cost pressures, business demography dynamics - and lagging effects of the natural disasters that hit the country in late 2017.

Chart 2 Insolvencies in 2018 (yearly change in %)



Sources: National Statistics, Euler Hermes

A persistent rise in Asia, notably China, and Africa

In Asia, economic growth is to remain firm, supported by improved prospects for trade and investment. Yet the region suffers from the side effects of the growth 'normalization' in China. Economic and monetary measures enacted to reduce financial risk, overcapacities and capital flows and to support the rebalancing and upgrading of the economy create turbulences for specific sectors and companies.

In 2018, insolvencies will continue to rise in China (+10%) - after a significant pick-up in 2017 (+35%) - and in Taiwan (+5% after +17%). Failure levels are estimated to remain almost unchanged in Japan and Hong-Kong (+1% after +0% for both countries).

The declining trend is set to be over in Singapore (+0%) Australia (+0%), South Korea (+0%) and New Zealand (+2%) where they reached low levels in 2017. Thus the regional insolvency index will increase further in 2018 (+6%), albeit at a slower pace (+14% in 2017). Still, it will remain below its 2008 peak.

In Africa, the regional rise in insolvencies (+6%) emanates from two major economies. Morocco with +8% after +12% in 2017; and the softening improvement in South Africa -3% in 2018 after -10% in the previous year.

A trend reversal in Brazil, but not for Latin America as a whole

We expect insolvencies in Latin America to stabilize in 2018 (+0%). This should take place after six consecutive years of rise and a sharp rise in 2017 (+17%) which led to a record high. In Brazil, the number of insolvencies should start to decline in 2018 (-7% after +5% in 2017), thanks to the easing of financial conditions and the acceleration of the economic recovery.

For the same reasons, the trend reversal initiated in Colombia in 2017 (-6%) remains on track for 2018 (-3%). But in Chile bankruptcies will stay on the upside (+5%), still boosted by the new procedures in place since 2014 with the new Insolvency Law.

Central and Eastern Europe improves again, after a tough 2017

The bounce-back seen in 2017 (+4%) was driven by two factors. First, the difficulties that companies faced in major countries such as Russia, Turkey and Poland as well as in Romania, due to VAT issues;

Second, the change in the Insolvency Law in Slovakia where failures skyrocketed by +78% (including sole proprietorship). In 2018, the region should return to the positive trend of a decline in insolvencies as seen in the 2014-16 period with a –4% decline.

Maxime Lemerle

Chart 3 Euler Hermes Global Insolvency Heat Map 2018

	Very low level (more than 10% below the 2003-2007 level)	Low level (between 0% and 10% below the 2003-2007 level)	High level (between 1% and 10% above the 2003-2007 level)	Very high level (more than 10% above the 2003-2007 level)
Strongly deteriorating strictly more than +5%	UK (+8%) Romania (+7%)			China (+10%) Morocco (+8%)
Deteriorating +1% to +5%	Taiwan (+5%) New Zealand (+2%) Japan (+1%) Hong-Kong (+1%)	Poland (+5%) Slovakia (+3%) Sweden (+2%)		Singapore (+5%) Chile (+5%)
Stable or improving -5% to 0%	Canada (0%) Estonia (0%) Russia (0%) South Korea (0%) US (-2%) Austria (-2%) South Africa (-3%) Germany (-4%) The Netherlands (-5%) Latvia (-5%)	Finland (-2%) Bulgaria (-5%)	Switzerland (0%)	Spain (0%) Australia (0%) Norway (-3%) Colombia (-3%) Luxembourg (-4%) Ireland (-4%) Turkey (-4%) Belgium (-5%) Lithuania (-5%)
Strongly improving strictly more than -5%	Brazil (-7%) Greece (-10%)		France (-7%) Italy (-10%)	Portugal (-7%) Czech Rep (-7%) Denmark (-9%) Hungary (-12%)

Sources: National Statistics, Euler Hermes

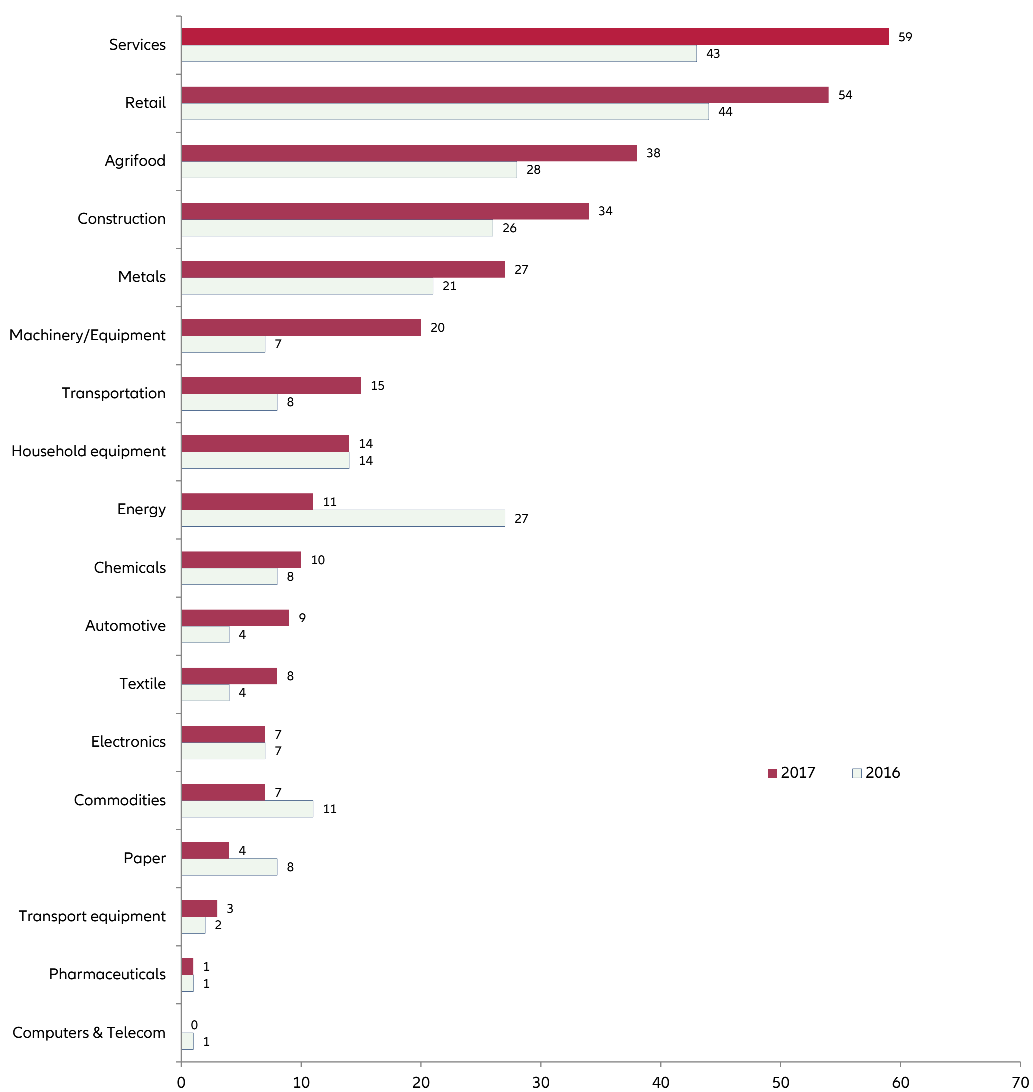
Major Failures
Broad-based Surge

While the total number of insolvencies is set to decline in 2018, the improvement will not be spread evenly. 2017 figures on major insolvencies – namely for companies with more than EUR 50 million in turnover – show the extent of the gap. Major failures increased every quarter last year. The number for the full year - 57 additional cases – meant that 321 companies went bust in 2017. Their cumulative turnover stood at EUR104bn. This is a EUR10bn hike compare to 2016.

Western Europe (up 42 cases to 138) and Asia (+17 to 63) are leading the climb. In terms of sectors, Services in Central and Eastern Europe, Retail in North America, Construction and Agrifood in Western Europe all sustained more than 20 major failures.

Global growth is in sync but risks abound: competition affects Services, digital disruption shakes Retail, commodity prices disturbs Agrifood, indebtedness weighs on Construction and overcapacity constrains Metals. Energy was the main sector that saw a decline in major failures, despite some big-ticket cases in North America and Europe.

Chart 4 Major insolvencies (*) by sector (in number)



(*) companies with a turnover exceeding EUR50mn

Source: Euler Hermes

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