Bank non-performing loans in 2021: The calm before the storm

Helped by extensive government support measures and payment holidays, many businesses have been surviving in 2020. In fact, bankruptcy rates have dropped in most countries. Support measures are not forever though. A sharp increase in non-performing loans is a question of 'when, not if', but will hit some countries more than others

Defaults and non-performing loans are deceptively quiet in 2020...

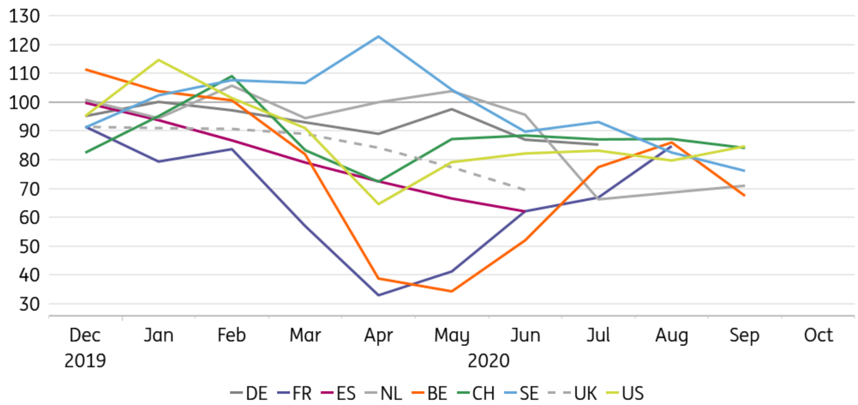
One lesson governments took from the 2008 and 2012 crisis response was: do not start increasing taxes and cutting expenditure too soon. That lesson was well heeded during the spring lockdown this year. Helped by accommodative monetary policy, governments indeed focused on supporting businesses and households. Austerity measures are nowhere on the agenda – yet.

Support for businesses took the form of tax deferrals and direct grants to compensate for lost turnover, and temporary employment benefits to allow businesses to keep their employees despite steep drops in revenues. Governments also devised loan guarantee schemes, allowing businesses with liquidity needs to borrow more easily from banks. Loan payment holidays were also implemented in many countries.

Regulatory measures were implemented to prevent banks from having to massively mark loans as problematic when a payment holiday was granted or a government guarantee was extended, which in turn would have impacted bank capital and discouraged bank lending. The ECB made sure there was ample liquidity in the financial system, providing TLTRO funding on generous terms.

As a result, bank lending sharply increased in the initial lockdown months. Though many businesses suffered, the number of defaults in many countries actually dropped, compared to a year earlier. In recent months, bankruptcies appear to stabilise at rates some 15-30% below what was "normal" just before Covid-19. This suggests that support packages while helping businesses getting through the crisis are also keeping alive a number of "zombie firms".

Number of business bankruptcies (seasonally adjusted, index, avg 2019 = 100)



Source: Macrobond, ING

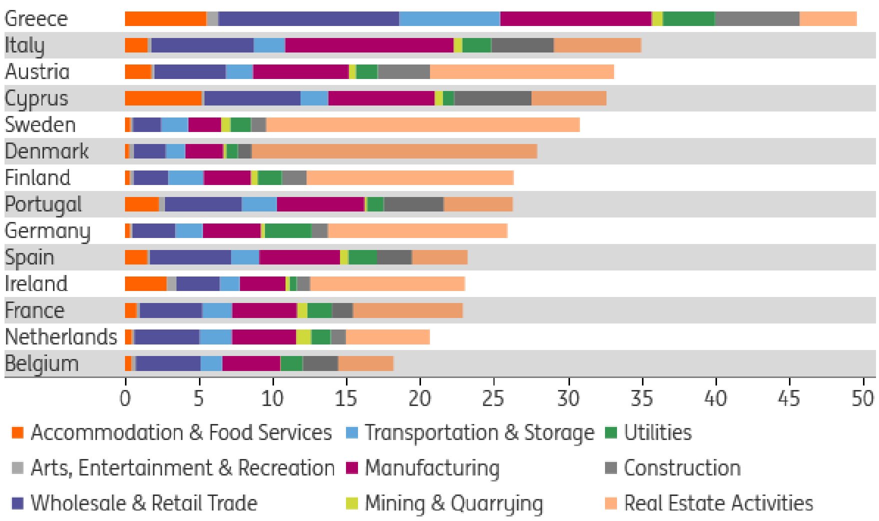
NPLs will rise everywhere in 2021, but some countries are more vulnerable

So what to expect for 2021? The Covid-induced recession will increase non-performing loans for banks when government support is phased out. "Zombie firms" that survived 2020 may further add to NPLs at that time. On the other hand, losses on loans that are covered by guarantee schemes will mainly accrue to government and less to banks. It appears that loan guarantee schemes were used more widely in countries in the south, mainly Spain and Italy but also France, than in northern countries. So, let's examine three factors that will drive NPL developments in 2021 and beyond:

1 Sectoral composition of corporate loan books

The sectoral composition of bank corporate loan books matters for NPL development. In the chart below, we show exposures to business sectors that are generally considered more vulnerable to the economic disturbances created by the pandemic response, as a share of the total loan portfolio (including exposures to households, government and financials).

Share of vulnerable sectors in total loan portfolio (%)



Source: ECB, ING

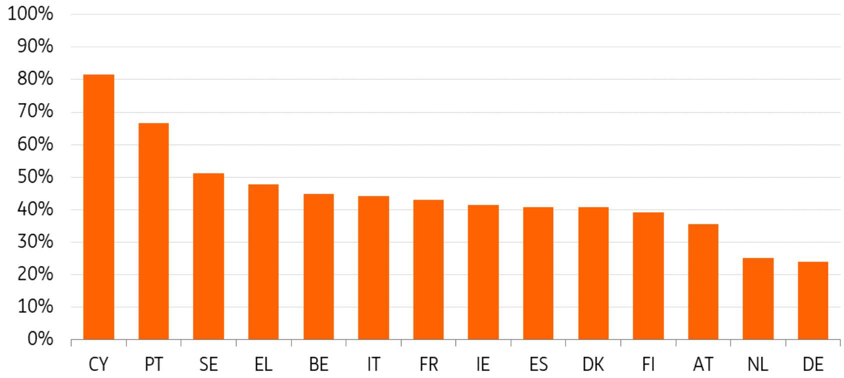
Generally speaking, banks headquartered in France, the Netherlands and Belgium have the lowest exposure to vulnerable business sectors. Vulnerable exposures in Scandinavia are mainly driven by commercial real estate loans. High exposures to the tourism sector can mainly be found in Greece, Cyprus, Ireland and Portugal, while Italian banks have relatively large exposure to manufacturing and trade.

It's important to consider that these sectors are normally impacted in different stages of the cycle, and a similar logic applies in the different stages of the Covid-19 crisis. Tourism, for example, is hit immediately and severely during lockdowns, but may also quickly recover. The same applies to transportation and storage. The initial hit to manufacturing was relatively less severe, but its recovery may also take more time. Real estate and construction may lag the most: initially, running construction projects are finished, while rents keep coming in as tenants survive on government support. As government liquidity is phased out, tenants may increasingly default. Meanwhile, a tepid economic recovery reduces demand for shopping space and a structural shift to working from home reduces office space demand. Construction companies will struggle with less well-filled new orders portfolios in the years ahead.

2 Share of SMEs in loan books

A second factor we consider for the NPL outlook is the share of SMEs in loan books. We assume that SMEs are hit relatively harder than larger companies, and may find it more difficult to recover. The share of SMEs in bank business loan books is highest in Cyprus, Portugal and Sweden, while the Netherlands and Germany score relatively low.

Share of SMEs in bank corporate loan books



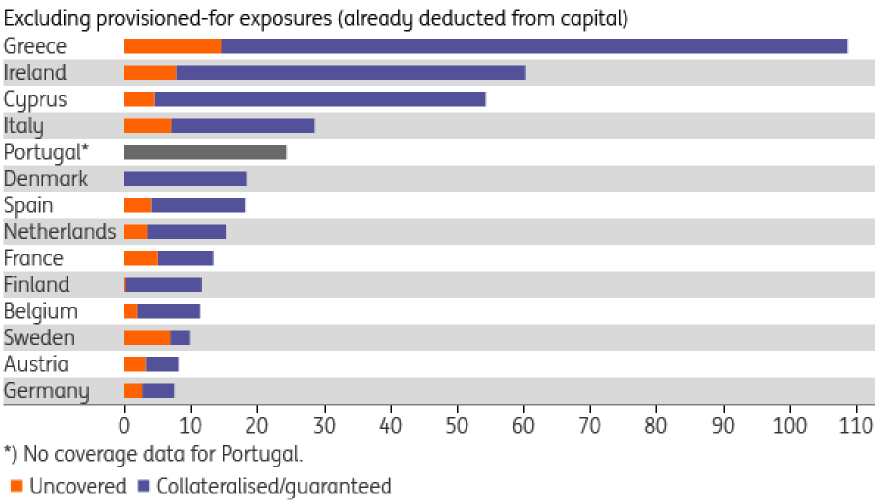
Source: EBA, ING. Note: EBA consolidates bank subsidiary loan data with the parent, but does not exclude it from host country data. This leads to inflated figures for countries with large presence of foreign banks.

3 Legacy NPL portfolios

To assess banks' ability to absorb NPLs, we look at the size of existing unprovisioned NPL portfolios as a share of bank capital. This is the pre-Covid legacy NPL luggage that banks bring into the Covid-19 crisis. Generally speaking, southern countries were already facing elevated NPL ratios before Covid-19, although in recent years a lot of progress has been made bringing those ratios down. Spanish NPL ratios (3.1% in 2020Q1) were converging to ratios in northern countries, while those in Italy and Portugal (slightly above 6%) more than halved between 2016 and 2020. The Italian banking sector has entered the Covid-19 crisis with NPL-ratios comparable to ratios before the 2008 financial crisis.

Unsurprisingly, Greece, Ireland and Cyprus top the list, while NPLs still comprise over 25% of bank equity in Italy and Portugal. Do note that in all countries, most of the non-performing exposures are collateralised or guaranteed yet the recoverability of such collateral varies. Of the southern countries, Spain is better positioned, both in terms of expected impact (in the eurozone loan book at least), and the ratio of existing NPLs over equity.

Non-performing exposures, % of bank equity

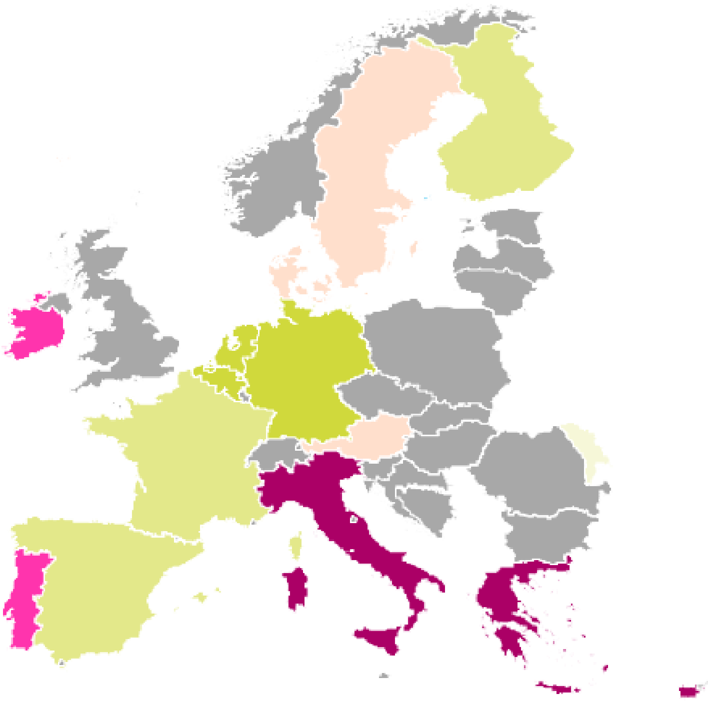


Source: ECB, ING

Taking it all together: where and when?

Three quite high-level indicators do not do justice to the nuanced and complicated nature of national NPL developments. That said, a worrying picture emerges. Covid-19 may deal another blow to those countries and banking sectors that are worst positioned to deal with it. Averaging the factors, NPLs are likely to continue to pose most challenges in Greece, Cyprus, Italy, Portugal and Ireland. Countries where we expect the smallest problems are Germany, Belgium, the Netherlands and Finland.

NPL heatmap



Source: Bucketing based on three factors above.

An important question is *when* NPLs will start to rise. Everything depends on the development of Covid-19 and government responses. Many businesses may currently depend on government support, for example, in the form of tax deferrals or wage payments, and may run into trouble once government support is phased out. This is currently expected to happen in the course of 2021. NPLs may further increase in 2022.

Author

Amrita Naik Nimbalkar
Junior Economist, Global Macro
amrita.naik.nimbalkar@ing.com

Mateusz Sutowicz
Senior Economist, Poland
mateusz.sutowicz@ing.pl

Alissa Lefebre
Economist
alissa.lefebre@ing.com

Deepali Bhargava
Regional Head of Research, Asia-Pacific
Deepali.Bhargava@ing.com

Ruben Dewitte
Economist
+32495364780
ruben.dewitte@ing.com

Kinga Havasi
Economic research trainee
kinga.havasi@ing.com

Marten van Garderen
Consumer Economist, Netherlands
marten.van.garderen@ing.com

David Havrlant
Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist
samuel.abettan@ing.com

Franziska Biehl
Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne
Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani
Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill
Credit Strategist
timothy.rahill@ing.com

Leszek Kasek
Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet
Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek
Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma
Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Rico Luman
Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen
Sector Economist
jurjen.witteveen@ing.com

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Nicholas Mapa
Senior Economist, Philippines
nicholas.antonio.mapa@asia.ing.com

Egor Fedorov
Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke
Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga
Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter
Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru
Chief Economist, Romania
valentin.tataru@ing.com

James Smith
Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen
Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer
Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz
Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland
Karol.Pogorzelski@ing.pl

Carsten Brzeski
Global Head of Macro
carsten.brzeski@ing.de

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com

Owen Thomas
Global Head of Editorial Content
+44 (0) 207 767 5331
owen.thomas@ing.com

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Peter Vanden Houte
Chief Economist, Belgium, Luxembourg, Eurozone
peter.vandenhoute@ing.com

Benjamin Schroeder
Senior Rates Strategist
benjamin.schroder@ing.com

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Gustavo Rangel
Chief Economist, LATAM
+1 646 424 6464
gustavo.rangel@ing.com

Carlo Cocuzzo
Economist, Digital Finance
+44 20 7767 5306
carlo.cocuzzo@ing.com