Dutch bankruptcy lessons for the eurozone

The number of bankruptcies in the Netherlands has been lower than during the Global Financial Crisis because of the nature of the crisis, structural changes and especially fiscal policy. Once temporary government support ends, the bankruptcy rate is expected to increase but remain considerably lower than at the peak of the GFC

Dutch case illustrative for lower number of bankruptcies in the eurozone

In a capitalist economy, economic shocks are often followed by a rise in bankruptcies, as money-losing businesses run short on liquidity and/or certain business models are rendered unviable. Given the large shock to the economy from coronavirus, more bankruptcies were to be expected. Yet a recent ESRB-report points out that the number of bankruptcies has not increased for a number of eurozone economies. In fact, the share of firms going bankrupt fell in many economies, in stark contrast to increases in the Global Financial Crisis of 2008.

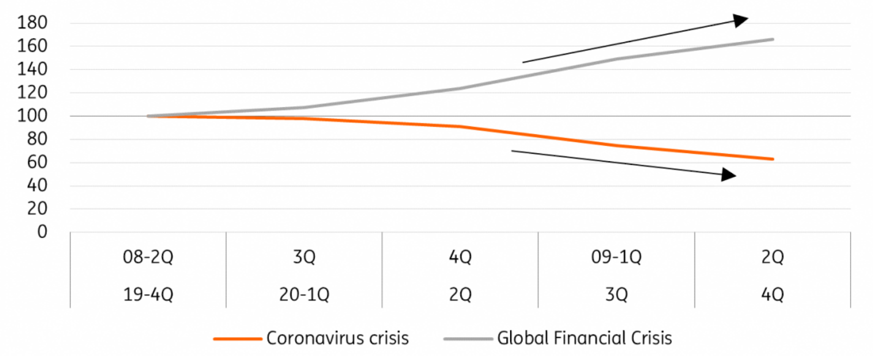
As case study, we look to the Netherlands to explain why the number of bankruptcies has been lower than during the previous crisis and to discuss the nature of the crisis, fiscal policy and structural changes. In most examples, these three multifaceted factors are also the reasons why, once temporary government support comes to an end, we expect the bankruptcy rate in the Netherlands to increase but to remain considerably below levels seen at the peak of the Global Financial Crisis, when 0.68% of all companies went bankrupt in a year's time. Due to upwardly revised GDP projections and the extension of temporary public support (see for example here), our current outlook on bankruptcies is less negative than in the early days of the coronavirus crisis.

Fall rather than rise in number of bankruptcies

The number of bankruptcies in the Netherlands fell by 37% between 4Q19 and 4Q20, while it increased by 66% between 2Q08 and 2Q09. Correcting for the fact that there has been an upward trend in the number of businesses, this means in the year since the onset of the crisis, 0.17% of businesses went bankrupt vs. 0.57% in the first four quarters of the Global Financial Crisis (and 0.68% at its peak). Excluding sole proprietors, which have a lower probability of filing for bankruptcy, the number of bankruptcies fell by 38% between 4Q19 and 4Q2020, while it increased by 103% between 2Q08 and 2Q09.

Number of bankruptcies falling now but rose in 2008-09

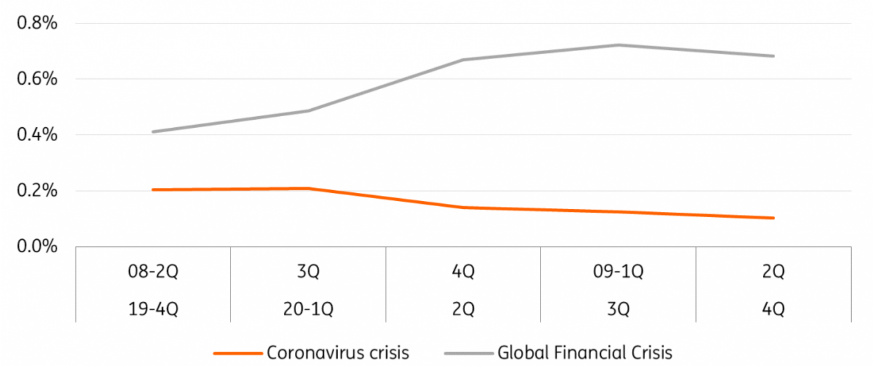
Number of bankruptcies in the Netherlands, seasonally adjusted index where last pre-crisis quarter = 100



Source: OECD, calculations ING Research

Bankruptcy rate lower than in 2008-09

Number of bankruptcies as ratio to number of businesses in the Netherlands, annualised*

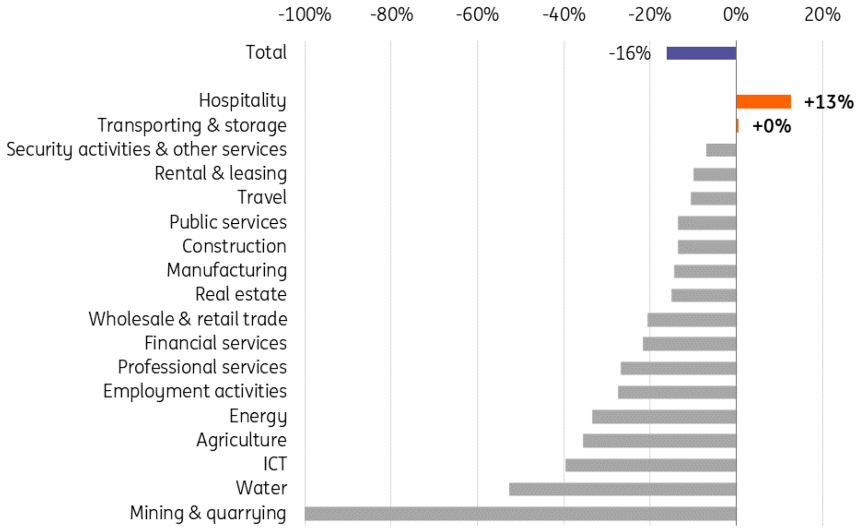


Source: CBS (Statistics Netherlands), calculations ING Research, *quarterly ratio multiplied by four

The fall in the number of bankruptcies compared to 2019 is widespread among most sectors. Yet, an increase in official insolvencies can be seen in two sectors; transportation & storage and especially hospitality, where the number of bankruptcies increased.

Fall widespread, but increase in bankruptcies in hospitality and transportation & storage

Change in number of bankruptcies in the Netherlands, 2020 compared to 2019



Source: CBS, calculations ING Research

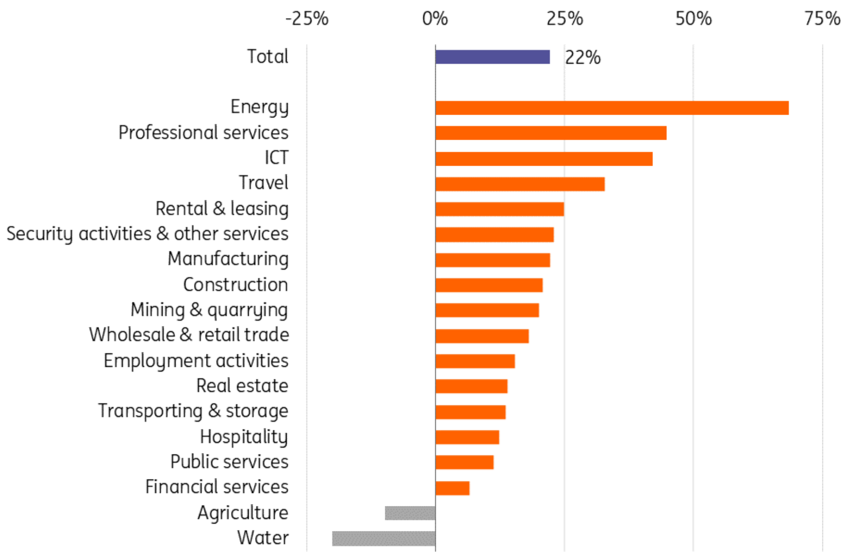
Widespread increase in the number of business exits

The fact that few sectors showed an increase in the number of bankruptcies does not mean that there is no negative effect from the coronavirus crisis on the business population. Poor economic performance sometimes leads to voluntary business exits rather than bankruptcies. And when troubled businesses have little collateral, creditors have little incentive to start a costly legal bankruptcy procedure. This often applies to small service providers, which were most directly affected by social distancing measures.

Indeed, the number of business exits (which also includes official bankruptcies) appears to have risen at the national level and in almost all sectors. The increase in business exits (+22%) is stronger than during the first four quarters of the Global Financial Crisis (+6%). The relative increase is larger now, possibly because exits started from a lower level: the share of firms exiting is 7.5% compared to 8.3% in 2008-2009. A similar picture of stronger increases emerges when we zoom in on “voluntary” exits only, i.e. business exits excluding bankruptcies: the increase is +23% now vs. +3% in 2008-2009. Also, the sectoral developments are very similar to those when bankruptcies are included.

Widespread increase in number of business exits

Change in number of business exits in the Netherlands, 2020 compared to 2019



Source: CBS, calculations ING Research

The increase in exits is especially prevalent among businesses with one worker (+26%), but can also be observed in many sectors for businesses with more than one worker (+1%).

Coronavirus crisis vs Global Financial Crisis

The number of bankruptcies has been low so far, and even though we expect to see more going forward, we generally expect these numbers to be less dramatic than during the Global Financial Crisis, for a number of reasons.

1 Nature of the crisis: shorter, smaller losses and sectorally different

Short temporary hiccup vs structural adjustment with longer drag

The nature of the coronavirus crisis is very different from the Global Financial Crisis, and so too is the effect on firms' balance sheets and the number of bankruptcies. The longer the economy underperforms, the more balance sheet deterioration and the higher the risk of bankruptcy. In 2020, Dutch GDP fell by 3.7%, the same percentage as in 2009. This might at first glance suggest that the coronavirus crisis is equally severe in economic terms as the Global Financial Crisis. But this is not the case. The Covid shock is transitory in nature, especially now that vaccines are gradually reducing the impact of the virus on the economy. In contrast, the shock of the Global Financial Crisis came from within the financial-economic system. This endogenous rather than exogenous shock forced many economic agents to adjust their balance sheets structurally, while currently, they often only have to make temporary adjustments.

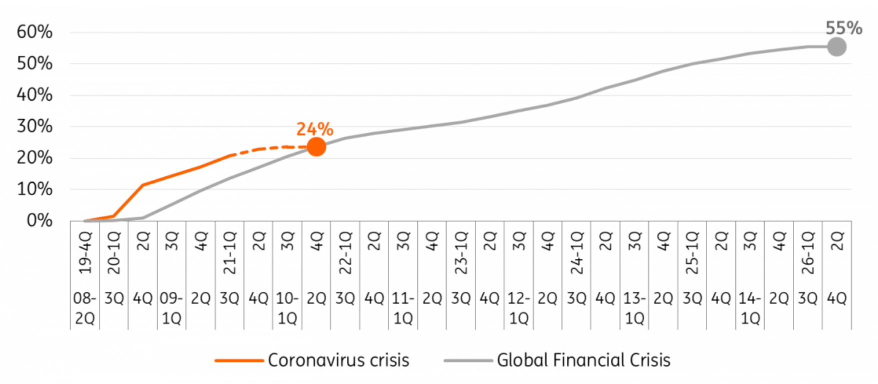
Indeed, in our current base line projection, we expect Dutch GDP to be back to its pre-crisis level of the fourth quarter of 2019 by the end of 2021. Even though the development of the virus is highly uncertain, it seems very likely that the rebound is a matter of a couple more quarters rather than years. This is vastly different from the Global Financial Crisis experience, when it took 26 quarters rather than 8 to rebound.

Cumulated GDP losses will likely be lower

When we cumulate the difference between actual GDP and its pre-crisis peak for each quarter until the rebound is completed (in line with our baseline forecasts), it shows that the expected GDP losses of the coronavirus crisis are about 43% (24% worth of quarterly GDP vs. 55%) of the losses during the Global Financial Crisis. In other words, the Global Financial Crisis was more than twice as severe as the coronavirus crisis in economic terms. For ease of exposition, we refrained here from accounting for the losses with respect to the trend path of GDP and therefore also for the differences in the trend, assuming that the economy will not return to the pre-crisis path (in line with the consensus view of many economist presented here).

Much smaller cumulated GDP loss than in Global Financial Crisis

Cumulative loss (difference between actual level and pre-crisis peak) in GDP of the Netherlands, seasonally-adjusted in constant prices

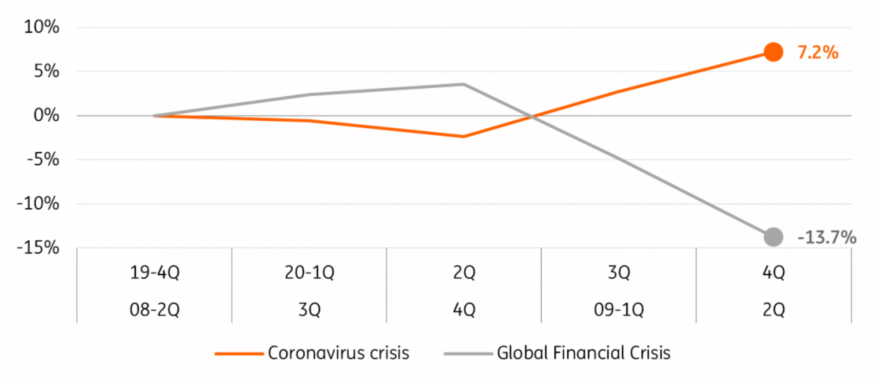


Source: CBS, projections ING Research

The fact that cumulated GDP losses are smaller so far on average translates into a surprisingly benign financial situation for businesses. This is illustrated by the rise in overall gross operating profits of 7% in 2020 (excluding unincorporated businesses such as the solo self-employed) in contrast to the (cumulative) fall of 14% in the first four quarters of the Global Financial Crisis.

Incorporated businesses have more positive development in 'profits' than in 2008-09

Cumulative change in nominal gross operating surplus of non-financial incorporated businesses in the Netherlands, seasonally-adjusted difference with level of last pre-crisis quarter

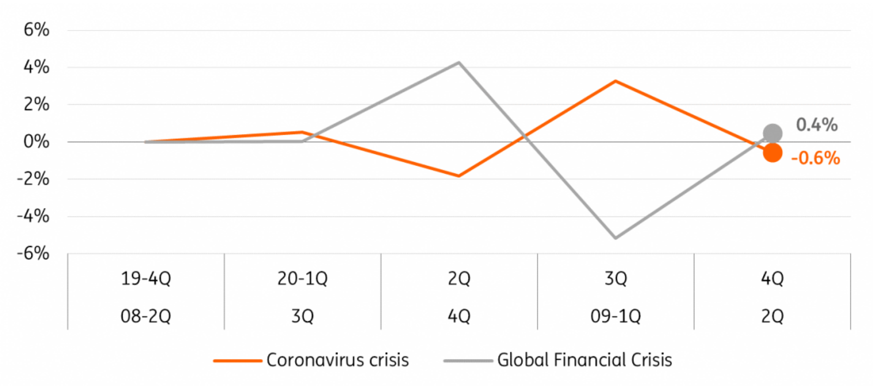


Source: CBS, calculations ING Research

Since gross operating surplus is not a good indicator for all businesses, we also look at mixed income, which is a very rough indicator of profits of the unincorporated solo self-employed. A somewhat different picture emerges here in comparison to the previous crisis. While the incorporated (often larger) businesses saw their profits rise instead of fall, smaller businesses saw profits develop similarly in the initial phases of the coronavirus crisis as during the Global Financial Crisis: a change close to zero. The somewhat more negative development of mixed income than in operating surpluses may explain why the coronavirus crisis so far has led to fewer bankruptcies and a stronger increase in business exits: small firms (defined as having one worker) are structurally almost twice as likely to exit than larger businesses (2.1% vs. 1.2%), and nine times less likely to go bankrupt (0.24% vs. 0.03%).

Unincorporated businesses experience a roughly similar development in "profits" as in 2008-09

Cumulative change in nominal mixed income in the Netherlands, seasonally-adjusted difference with level of last pre-crisis quarter



Source: CBS, calculations ING Research

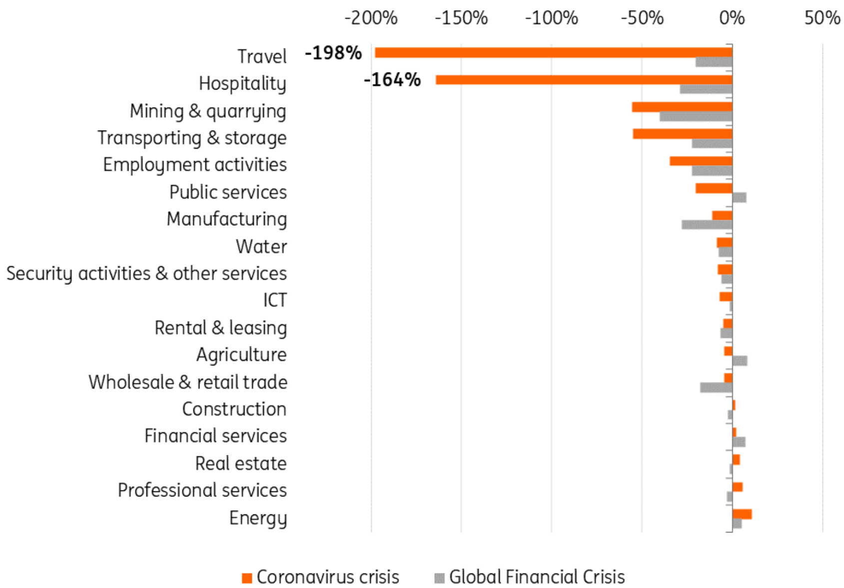
Severe shock hits sectors with fewer companies

In the current crisis, mining and quarrying (gas and oil) and especially hospitality and travel agencies (within administrative and support service activities) and travel & storage were among the sectors with the largest negative shock to gross value added cumulatively in the Netherlands four quarters into the crisis. During the GFC, the sectors hit most were mining and quarrying (gas and oil), hospitality and manufacturing.

While these rankings seem similar in both periods, the story is very different; travel and hospitality lost about 160-200% of quarterly value added this time around, while during the GFC cumulated losses did not surpass 40% during the first four quarters. Also, when we take more quarters into account, construction stood out as one of the most-hit sectors but has posted net growth so far in this crisis. So, the recent extreme output losses are more concentrated in a few sectors. Also, the story on mining and quarrying is different. While the output loss was the result of low demand during the GFC, current falls are also caused by ever stricter gas production restrictions (aimed at preventing earthquakes in the northern province Groningen).

Impact on value added is more heavily skewed towards travel and hospitality

Cumulated gross value added loss compared to pre-crisis peak quarter in first four quarters, seasonally adjusted in constant basic prices

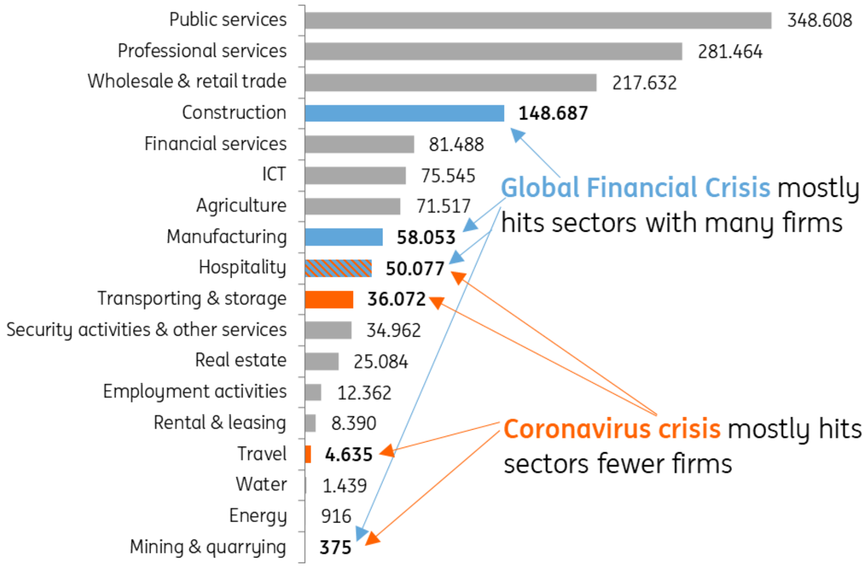


Source: CBS, calculations ING Research

When different sectors experience different falls in activity between the two periods, the expected number of bankruptcies is different. Indeed, while during the GFC, sectors with many firms took the largest hit in value added, during the coronavirus crisis, some severely hit sectors involve fewer firms.

Severely hit sectors are less populated sectors

Number of businesses, average in 2009-2010



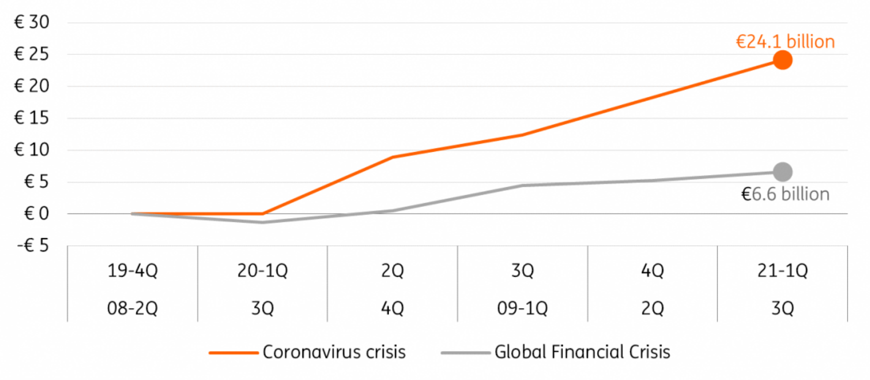
Source: CBS, calculations ING Research

Unprecedented forced household savings have potential to improve business finances

Given that fiscal stimulus (discussed in more detail below) is supporting incomes, the balance sheets of many households has been only mildly affected by the current economic crisis. This, combined with the closure of many shops and services aimed at containing the virus, led to a record increase in accumulated savings in consumer deposits. While less important in explaining the fact that the bankruptcy rate has been low so far, we believe that savings will play an important role in keeping the numbers below the peak seen during the GFC. A lot of the current savings are forced, since households wanted to spend but were unable to. Additional savings in the GFC were, however, precautionary, for example out of fear for unemployment, and also much smaller. Forced savings seem more likely to be spent in the near future than precautionary savings, which are more likely to be used to improve balance sheets.

More cumulated additional household deposits inflows than in 2008-09

Cumulative additional net inflow into bank deposits of Dutch households, seasonally-adjusted difference with level of last pre-crisis quarter in billion

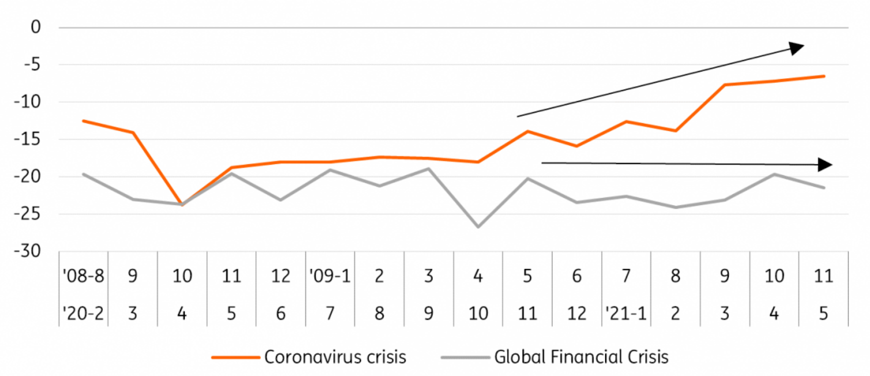


Source: DNB (Dutch Central Bank), calculations ING Research

We believe that the majority of these current savings will not be spent any time soon, given the fact that these are mostly concentrated among high-income households. However, such vast amounts imply there is the potential for a lot of pent-up demand for business to service once social distancing measures become negligible, more so than in the aftermath of the GFC. 'Additional' deposits cumulatively increased by €24 billion in the first five quarters compared to less than €7 billion in 2008-2009 while consumers' willingness to make a major purchases in the next 12 months is also higher and increasing this time around. It is likely that a significant share of the money will be spent in the most affected sectors: travel and hospitality.

Higher and quicker improving willingness to buy in future

Willingness to buy in the next 12 months indicator for the Netherlands*



Source: DGECFIN, calculations ING Research, *Seasonally adjusted net balance of %-points positive and negative responses to question "Compared to the past 12 months, do you expect to spend more or less money on major purchases over the next 12 months?"

2 Fiscal policy: More generous and better prospects

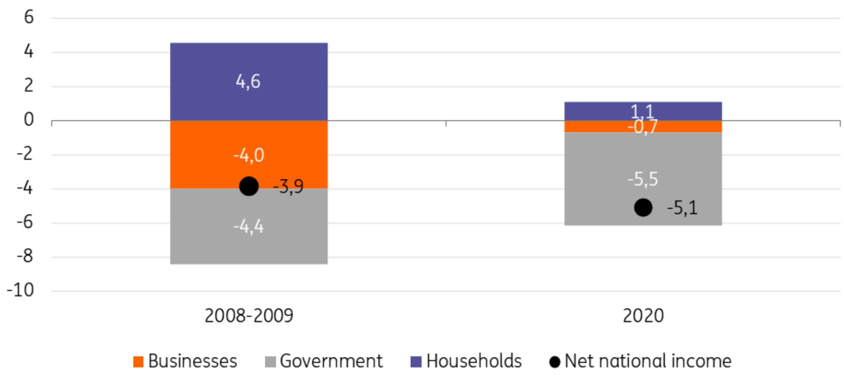
The second and most important reason for the fall in the number of bankruptcies is fiscal. Vast amounts of public support for firms have held structurally viable firms with large turnover losses afloat, which could have kept the number of bankruptcies constant. But the number of bankruptcies actually fell: also some firms with unviable business models profited from measures such as tax deferrals and wages subsidies, since it is difficult for the government to distinguish between viable and unviable businesses. That said, this probably applies to a very small share of all businesses, as might be indicated by the fact that the cumulated difference between the initial increase in the bankruptcy rate in 2008-2009 (+0.75% at an annualised rate) and its recent fall (-0.16%) is only 0.91%, assuming that the experience of the GFC is indicative of roughly undistorted business dynamics.

Fiscal support is more generous; government takes a larger share of the hit

While the Dutch government responded to GFC with fiscal stimulus, this was short lived. It was also much smaller than the fiscal response to the coronavirus crisis. This means that balance sheet deterioration has been more limited this time around. This is illustrated by the changes in the contributions to the change in national income. Where total real net national income fell 3.9% on average in 2008-2009, it fell 5.1% in 2020. What's more important is that the negative contribution of businesses was large (-4.0%-point) in 2008-2009 but only -0.7%-point in 2020. The government is taking a larger hit now, with a contribution of -5.5 percentage points to the development of net national income in 2020 compared to -4.4 percentage points in 2008-2009.

Fall in net national income more at expense of the government and less at businesses

Average annual change in real net national income (year-on-year in %) and contribution to it (in %-points)

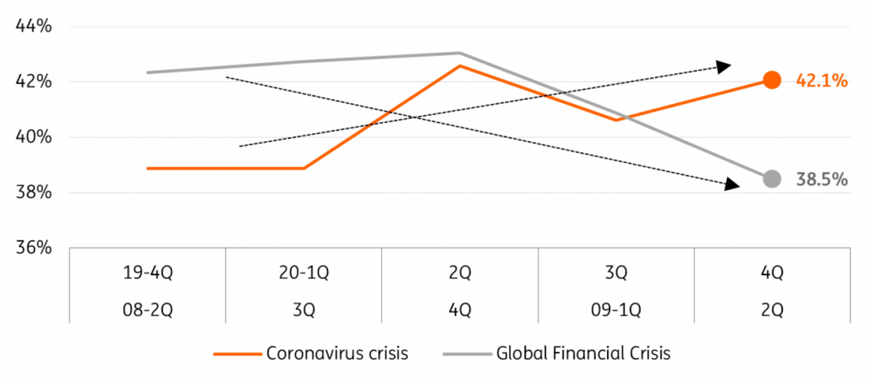


Source: CPB (Netherlands Bureau for Economic Policy Analysis) CEP March 2018 and March 2021, calculations ING Research

The fact that the large GDP shock affected business less in 2020 than in 2009 is also illustrated by the rise in the profit ratio (gross operating profits as a share of value added of non-financial firms - excluding unincorporated businesses such as solo self-employed) in 2020, compared to a fall in 2009. This macro figure obviously hides the fact that specific businesses and sectors saw a considerable fall in their financial performance: it is the average of both winners and losers.

Profit margin of incorporated businesses increased while it fell in 2008-2009

Nominal gross operating surplus of non-financial incorporated businesses as ratio to value added in the Netherlands, seasonally-adjusted



Source: CBS, calculations ING Research

Soft landing: Cliff-edge of retreating public support less frightening than it seems

As it stands now, almost all temporary public support measures will end 30 September 2021, later than initially intended. Businesses with already unviable business models might consider this a cliff-edge. Businesses with models that are structurally viable but with high temporary losses will, in some cases, stay afloat and in other cases still have to file for bankruptcy. But not all support is withdrawn all at once. Liquidity support in the form of deferred taxes will not be terminated immediately. The latest figures suggest this amounts to a total of €16.4 billion (2% GDP) for 252,000 businesses. Businesses will have to start paying back from 1 October 2022, but are allowed to take up to 60 months in this process. Even though deferred taxes are also a liability, they prevent bankruptcies caused by liquidity problems. This long payback period should limit the increase of the bankruptcy rate and may also imply that bankruptcies will be spread over a longer period of time. While under specific conditions, firms could also opt for tax deferral during the GFC, this option is now far more widely available with much more generous conditions and should keep the increase in bankruptcies more limited this time around.

No austerity expected soon: Better prospects

The Dutch government opted for austerity measures when the economy had not yet recovered from the GFC. Such a move is not expected any time soon. This limits further losses for businesses and raises the prospect of keeping bankruptcies further in check in the current crisis. Since after the March 2021 general election, a new government still has to be formed, unexpected changes to fiscal policy (including a recovery plan) cannot be fully excluded. Based on the analysis of political manifestos, structural fiscal policy is however more likely to be expansionary than contractionary in the medium term. While structural spending is expected to increase, it is likely that this will not fully offset the retreat of temporary spending. But in any likely case, no similar austerity effect on bankruptcies as in 2010-2014 should be expected any time soon.

Structural changes: Labour costs more adjustable and different restructuring regime

Policy changes for debt restructuring reduces collective action problem

In contrast to countries like Belgium and Italy, which froze ongoing bankruptcy procedures and/or stopped accepting bankruptcy applications up to a certain date, the Netherlands did not temporarily change the broad functioning of its bankruptcy procedures in response to the coronavirus crisis. But the Dutch government had already been working on new permanent legislation for several years. As of 1 January 2021, the new Act on Court Confirmation of Extrajudicial Restructuring Plans to Avert Bankruptcy (Wet Homologatie Onderhands Akkoord or WHOA) has been effective. How this act plays out in practice has yet to be seen, but in theory it should allow businesses to agree more easily to debt restructuring plans with creditors. In cases where the majority of creditors are in agreement, this new law should prevent a single creditor from rejecting the entire plan. We expect this to lower the (increase in the) bankruptcy rate, since it should facilitate the restructuring of businesses with large debt burdens that still contain viable business operations. During the GFC, one creditor could block a restructuring plan, which likely resulted in more bankruptcies.

Temporary payment deferment measure could have a downward effect on number of bankruptcies

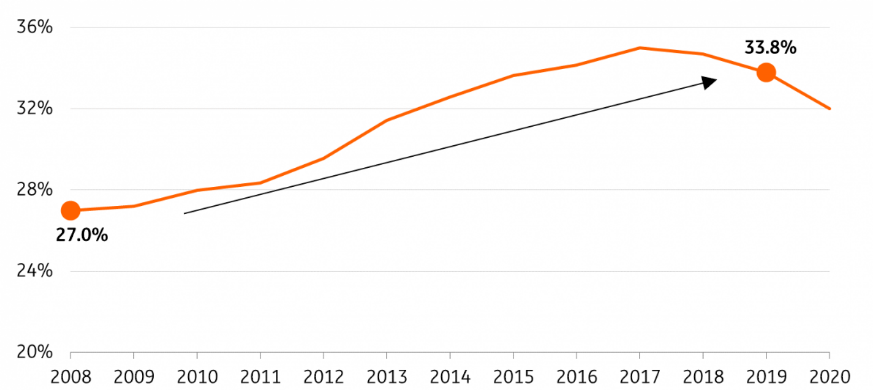
The Dutch government introduced a temporary (until mid-2021) option to defer payments to a creditor that filed for bankruptcy of the firm, aimed at preventing bankruptcies based on a temporary lack of liquidity in firms with long term viability. This came with the option for the firm to apply in court to defer the handling of the bankruptcy request for two months, which could be followed up with two more deferrals of two months. While we can't rule out that this could lead to a stronger increase at a later point in time, it may have delayed and in some cases prevented some bankruptcies. (No data available).

Larger flexible labour share allows for quicker labour cost reduction

Dutch firms have structurally increased their use of flexible workers in comparison to start of the GFC. Their share in total employment rose from 27.0% in 2008 to 33.8% in 2019. Flexible labour such as temporary contracts, contracts with no fixed number of hours, and the services of temp agencies and solo self-employed allow firms to change their labour costs more easily in case of positive or negative demand shocks, thereby reducing their insolvency risk. Indeed, 2020 data shows that firms primary offloaded flexible workers, much quicker than during the GFC.

Share of flexible labour much higher going into the crisis than in 2008-09

Share of flexible relations (employees* and solo self-employed) in total employed labour force (15-75 years old), seasonally adjusted

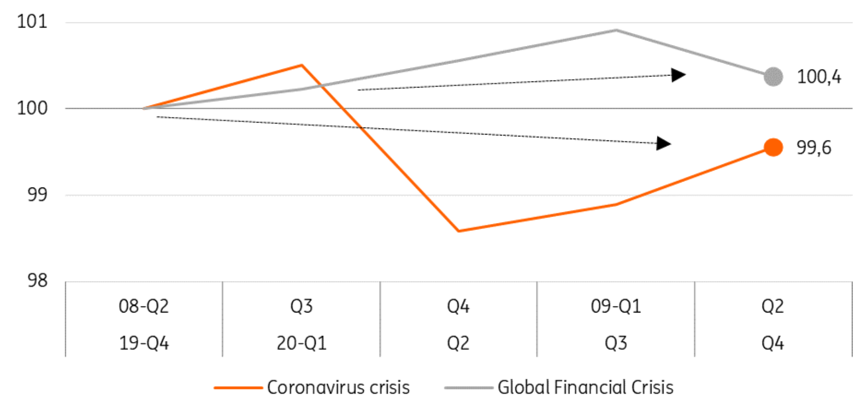


Source: CBS, calculations ING Research, *Includes temp agency workers, on-call, no fixed hours and temporary contracts

Total employment was scaled back fast during the current crisis, while it initially still continued to grow in the GFC. This may partially explain why the change in net national income for households was less positive during this crisis than in 2008-2009 and, more importantly for bankruptcies, the change in net national income for businesses was less negative.

Employment falls quickly while it continued to grow at first in 2008-2009

Employed labour force (15-75 years old), seasonally adjusted index where last pre-crisis quarter = 100



Source: CBS, calculations ING Research

More bankruptcies on the horizon, but no repetition of the Global Financial Crisis

We conclude that the number of bankruptcies is artificially low. It would have been higher, along with unemployment, without the vast public support measures. When these measures fade, an increase in the number of bankruptcies should be expected, as not all business losses due the Covid-crisis have been compensated for. Because of the specific nature of this crisis, the fact that fiscal policy is more accommodative for the outlook and a number of structural changes have been made, we expect the share of bankruptcies in the Netherlands to remain lower than during the aftermath of the GFC. Since uncertainty surrounding the virus and the viability of businesses is high, a higher number of bankruptcies than expected remains a risk to our base line projections.

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