Striking differences in Eurozone business borrowing during Covid-19

Eurozone businesses borrowed heavily in the early lockdown months, but liquidity needs have come down substantially since then. Differences between countries remain striking though, and government-provided liquidity cannot last forever

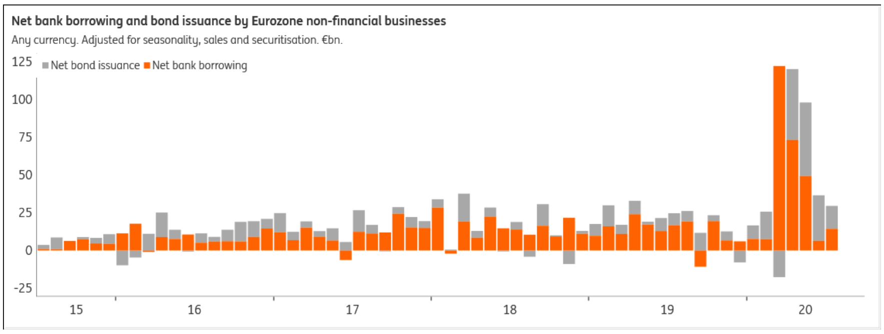
Business financing back to normal?

In the early months of the lockdown, Eurozone non-financial businesses faced acute liquidity stresses and borrowing from banks hit record highs as credit lines were drawn. Non-financial businesses borrowing from banks reached €122bn in March, almost double the previous monthly record of €68bn, set in December 2007. April and May saw strong net borrowing as well, and businesses also started to tap bond markets in substantial amounts.

> *Figures conceal distinct country differences in where businesses get there liquidity from*

By then, some of the bank credit lines drawn out of precaution were being repaid, and borrowing at banks returned to "normal", though bond issuance remained elevated. But of course, nothing is "normal" right now. Eurozone aggregate financing figures conceal distinct country differences in business reliance on bank loans vs bond issuance vs government emergency liquidity. In turns, this drives different expectations for financing needs in the future. Let's have a closer look.

Eurozone bank loans by sector



Source: ECB, Macrobond, ING Research

Stark differences between Eurozone countries

Looking at the larger Eurozone economies, the demand for bank loans has remained elevated especially in Italy and France, and initially also in Spain, as you can see in our chart 'fest' below. In Italy, businesses hardly did any bond issuance in net terms. This should not surprise us, given the relatively high share of SMEs with no access to capital markets in Italy. Instead, reliance on bank loans remained elevated until July (the latest month for which data is available). The fact that approval procedures for guaranteed loans were complex initially, but simplified over time, may also explain the prolonged demand for bank loans.

The contrast with Germany, Belgium and the Netherlands is stark

The contrast with Germany, Belgium and the Netherlands is stark. In these countries. bank borrowing fell back after the initial surge and even turned negative in the summer. Larger businesses, instead, tapped bond markets. France is truly in the middle: both bank borrowing and bond issuance remain strong. A number of country-specific characteristics play a role in the observed country differences, but we highlight three overarching themes here.

Net bank borrowing and bond issuance by non-financial businesses

Source: ECB, Macrobond, ING Research

1 Three important things to note

The severity and economic impact of the lockdown was generally bigger in Southern Europe than in northern countries. Given the sectoral composition of economies (e.g. the reliance on tourism), the summer recovery was likely quicker in the north.

Although government support packages are difficult to compare across countries, it appears that the German and Dutch governments, in particular, provided generous tax deferrals (delayed payment of VAT and corporate taxes). Insofar as businesses could rely on "tax credit", they did not need liquidity from their banks. Estimates on the size of the liquidity provided by taxes not paid vary but, for example in the Netherlands, this source of liquidity since March appears at least as big as the financing obtained from banks and bonds combined.

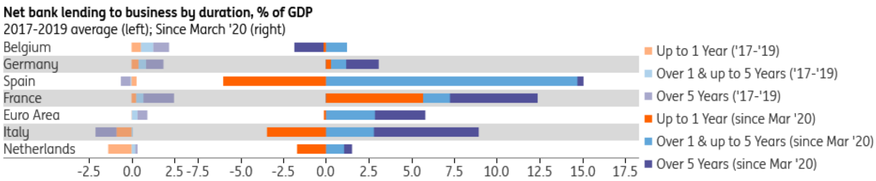
Bruegel dataset on government support packages (be careful though, as loan moratoria are counted as "tax deferral", which, for example. confusingly pushes up the Italian numbers).

In Italy in particular, the government chose to provide liquidity mainly by guaranteeing bank loans and putting in place loan moratoria with partial government guarantees. This makes Italian business more reliant on bank liquidity, as opposed to deferred tax liquidity. That would explain both a bigger need and increased preference for these loans compared to other countries.

Further support for this hypothesis is given by the fact that Italian bank lending has been shifting towards longer durations since March. The chart below shows a marked shift from durations shorter than 1 year to the 1-to-5 year segment, and even above the 5-year level. We see a smiliar shift in Spain. The Netherlands also saw a decrease in shorter duration loans, but this decrease was already ongoing before Covid-19 and thus does not correlate with corona-related government support packages. Germany, France and the Eurozone as a whole do not show a clear duration shift. This suggests to us -- though by no means proves -- that government guarantees and loan moratoria invited stronger reliance on bank loans in Italy and, to a lesser extent, Spain.

Eurozone gross v net lending

Note the decline in the Belgian >5y figure is entirely driven by a sale/securitisation in July, and does not reflect an actual decline in long-term loans outstanding.



Source: ECB, Macrobond, ING Research

Any increase in business demand for finance remains contingent on economic developments

It's good that we get to understand a bit more what drives observed country business credit differences you say, but what about the future? It was clear from the start that emergency support could not last forever. Moratoria have ended or are ending. Going into 2021 we will see a reduction or even a phasing out of government support. Businesses will find that deferred does not mean condoned, and those taxes will have to be paid after all. The phasing out of various sources of liquidity will be difficult for businesses that were already struggling. Layoffs and bankruptcies are bound to increase at some point. Banks and other creditors will be confronted with loan defaults. Lenders have been preparing for this by taking provisions.

> *Businesses will find that deferred does not mean condoned, and those taxes will have to be paid after all*

Other businesses may react to reduced government liquidity by (further) postponing or cancelling investment plans, and/or by increasing bank borrowing (and bond issuance). Therefore, notably for those countries with currently generous tax deferrals and wage subsidies, demand for bank loans and, to a lesser extent, bond financing may increase more if and when government measures are phased out compared to countries with less extensive government packages. How strong this increase in demand will be, however, is highly uncertain at this stage. The weaker the economy, the less companies will want to invest and borrow. As we set out in our Monthly Update, the further development of the virus and the timing and distribution of any vaccine are key to economic developments, which in turn drive financing needs.

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