

Germany: Insolvencies - a risk to the 2021 outlook

Once the second lockdown is behind us, the economy should return to a solid recovery. A rise in insolvencies, however, poses a clear risk to the 2021 outlook



In addition to the economic stimulus packages, guarantees, state aid and loans that the German government has adopted since the outbreak of the Covid-19 pandemic, there have been two other important decisions with a significant impact on the economy: the famous worker-retention programmes and the lesser known suspension of the obligation to file for insolvency. While the former has already been extended until the end of 2021, an end to the latter could be a severe risk to the expected 2021 recovery.

The obligation to file for insolvency was initially suspended until 30 September. Since then, only companies with over-indebtedness directly related to the pandemic have been exempt, remaining so until the end of the year.

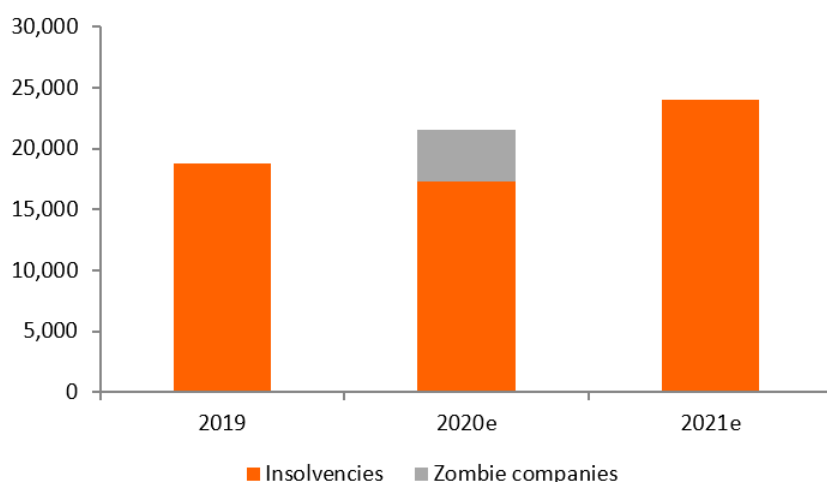
As a result, the wave of bankruptcies predicted by many experts has not materialised, yet. The most recently published figures on company bankruptcies for the month of October are completely counterintuitive and well below the level of the previous year. According to the Federal

German Statistical Office, the number of opened regular insolvency proceedings in October fell by 45.8% compared to the same month last year. The Cologne Institute for Economic Research forecasts around 17,250 corporate insolvencies for the year 2020 as a whole. The lowest level since 1993.

Rise of the zombies?

However, the suspension of the obligation to file for bankruptcy has meant that banks and business partners of companies in difficulty may not be aware of this and could continue to lend money or enter into contracts. This would normally create room for competitors who are economically better placed. At present, however, these companies are able to remain in the market and continue to operate at the expense of their competitors, despite losses and a lower chance of survival. These companies are therefore often referred to as "zombie companies". The Cologne Institute for Economic Research estimates that the number of these companies is currently around 4,300. While the instrument of short-time work may only delay possible structural change, the suspension of the obligation to file for insolvency creates the danger of an undesired chain reaction, in which even 'healthy' companies could run into problems.

German insolvencies could rise sharply in 2021



Source: Federal Statistical Office, Cologne Institute for Economic Research, Creditreform

Insolvencies - a potential risk for 2021

With the second lockdown and possible return to normal insolvency rules, there is a clear risk that 2021 could see a sharp increase in insolvencies in Germany. The business information agency Creditreform predicts a significant increase in insolvency proceedings, up to 24,000 in 2021. Increases in the sectors most affected by the restrictions, such as tourism, catering and the cultural and events industry, are likely. Such a rise would be the third largest annual increase since 1950, after 1974 and 1982. With 24,000 possible proceedings, the year 2021 could be the worst year since 2014 in terms of the absolute number of insolvencies.

At the current juncture, it remains unclear whether and how the German government wants to extend the tweaked insolvency rules. Given the nature of this crisis and given that more freelancers and small companies are most affected by the crisis, a sharp increase in insolvencies might not have the same impact on the labour market as in previous recessions. Still, a wave of

insolvencies at the start of an election year will not be in the interest of the government.

Author

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

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