EULER HERMES

Prepare for another year of rising insolvencies, the collateral damage of too-low growth and tightening financial conditions

- At a global level, the upward trend in business insolvencies continued in 2018 (+10% y/y), mainly due to the surge in China (+60%) and, to a lesser extent, an increase in Western Europe (+2%)
- In 2019, business failures are set to rise for the third consecutive year (+6% y/y): the softening economic momentum to a too-low pace of growth, coupled with the global tightening of financing conditions, will drive up insolvencies in a majority of countries

Paris, 9th January 2018 – In 2018, global insolvencies confirmed their upward trend which started in 2017 after seven consecutive years of sizable declines.
Indeed, our Global Insolvency Index which covers 43 countries totaling 83% of global GDP is to post a +10% y/y increase for 2018. All in all we expect 20 countries of our sample to see in 2018 more insolvencies than in 2017.

Three factors explain this outcome:

- A weaker macroeconomic context for some countries;
- The implementation of new types of insolvency procedures and the cleaning of business registers through the official insolvency procedures in a few other countries;
- More significantly, the stronger willingness to use the insolvency framework in China.

Business insolvencies will increase in 2019 because the pace of growth is too slow

In our view, the upside trend in insolvencies will continue in 2019 (+6% y/y). However, this outlook will reflect a more universal reason: the soft landing of the global economy to a slower pace of growth at 3.0% in 2019 from 3.1% in 2018 and 3.2% in 2017. We expect real GDP growth to soften in the US (from 2.9% in 2018 to 2.5% in 2019), the Eurozone (from 1.9% to 1.6%) and Asia (from 5.1% to 4.8%). .

De facto, this lowering demand is increasing the vulnerability of companies with high-fixed costs and firms with larger inventories or issues in their working capital requirements. At the same time, the end of easy financing is increasing the vulnerability of debt intensive sectors and more globally, the vulnerability of the most indebted companies.

In fact, most economies, notably the developed ones, are expected to revert to and even cross their respective tempo of GDP growth which has historically proved to be necessary to stabilize the level of insolvencies (+1.7% for Western Europe).

In other words, we expect economic growth to become gradually insufficient for a higher number of companies in a higher number of countries with regard to their production costs, (re)financing costs and structural challenges.

In this context, we foresee 2 out of 3 countries will post an increase in business insolvencies in 2019 (compared to 2 out of 5 in 2018) and 1 out of 2 countries to register more insolvencies in 2019 than observed in average over 2003-2007, before the financial crisis of 2008.

It should be said that countries that exhibited dynamic business creation over the past years will face an extra volume of insolvencies due to young companies being too weak to survive: startups beware!

China to clean its zombie' state-owned enterprises

The surge in insolvencies in China will keep driving up the regional (and global) insolvency figures.
Indeed, in 2018, business insolvencies continued on a huge double digit growth (estimated at +60%) according to the available non-official data, thus confirming the official pickup posted in 2017 (+74% to 6,257 cases according to the Supreme People's Court of China).

We expect another double-digit increase of insolvencies in 2019 (+20%). Firstly, because of the ongoing softening and adjustments of the Chinese economy, notably with regard to credit growth, Belt and Road Initiative and international trade issues. Secondly and most importantly, Chinese authorities have decided to clean out its 'zombie' state-owned enterprises (exceeding 20,000 cases according to some studies).

"*All in all, this insolvency outlook calls for more selectivity and preventive actions such as stellar credit management practices by risk managers and business leaders worldwide. It also calls for a close monitoring of the political and policy-related risks which will nurture volatility all along 2019 even if we expect positive outcomes for most of them in our base line scenario*", said **Ludovic Subran, Global Head of Macroeconomic Research at Allianz and Chief economist at Euler Hermes**.

Our latest Global Insolvencies report is available here

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