ALLIANZ RESEARCH

EUROPEAN CORPORATES LOADING UP CASH AGAINST UNCERTAINTY

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At the end of H1 2020, we estimate the net savings of EU non-financial corporates, i.e. cash from operating activities, to have doubled to over EUR700bn, or more than 4.5% of GDP. In crisis times, companies' revenues decline but there are also significant cuts in investment plans, lower payroll costs, lower taxes and dividend cuts. All these factors enable non-financial corporates to increase their net savings positions, which we call cash provided by operating activities. With the Covid-19 crisis, we find that companies are doing the same.

In H1 2020, the partial unemployment benefits schemes in most of the EU countries managed to protect corporates' EBITDA from much stronger falls, given that their revenues as measured by the gross value added are estimated to have dropped by -13% on average. We expect EBITDA to have lost -13% in Q2 after being stable in Q1. Lower oil prices have also helped companies to reduce their intermediate consumption and protect their EBITDA. In addition, lower tax payments, estimated at -30% compared to end-2019, have allowed corporates to improve their gross disposable income, or gross savings, by +30% or around EUR360bn to EUR1.5trillion in H1 2020 (see Figure 1). Hence, net savings, i.e. gross savings minus capital depreciation or cash from operating activities, is expected to have doubled, to more than EUR700bn in H1 2020. In comparison, in 2009, net savings increased by +25% to EUR160bn in the EU (see Figure 2).

Since March 2020, EU non-financial corporates have also rushed to load up cash as insurance against uncertainty, encouraged by the more than EUR1tn of public guarantees put in place by European governments to boost bank loans to corporates and avoid a liquidity crisis (see Figure 3). In April, growth of loans to corporates have reached its highest level since 2009, at +6.6% y/y (up by EUR73bn in April following EUR121bn in March). In France, total state guaranteed loans stood above the ones granted by the other European countries. They are expected to reach EUR120bn by September from the current EUR85bn (and out of the EUR300bn total guarantees). A relatively low estimated default rate of 5% to 10% over the next three to four years could suggest that a large part of these loans are precautionary against a potential liquidity stress.

Excess cash – i.e. net savings plus new bank loans to non-financial corporations less gross fixed investment – increased in 2009 and has declined only slightly since, a consequence of slow domestic demand growth but also a sign of caution from non-financial corporations. The

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lower commodity prices, lower corporate taxes and slow wage growth since 2009, have allowed EU non-financial corporates to keep relatively high net savings over the past years (see Figure 4). In addition, corporates have benefited from the very accommodative monetary policy. This has allowed them to take out more bank loans, notably since 2015 when the ECB implemented its quantitative easing program (see Figure 3).

If we combine both – i.e. net savings and new bank loans but subtract gross fixed investments – we derive what we would call excess cash: non-financial corporations, first and foremost German ones, have built sizeable cash buffers on their balance sheets (see Figure 5). Over the past few years, the accumulation of fresh cash balances by non-financial corporations, along with the rise in household savings, and the fall in velocity of money measured as M2 growth over GDP growth, makes us fear that cash hoarding in the private sector in the EU is becoming endemic. As a form of self-insurance against income disruption, it reflects low confidence in future growth and goes a long way to explain subdued investment activity over the past few years. Finally, cash hoarding could potentially lead to payment delays and in fine business insolvencies.

In H2 2020, we expect companies' net savings to reduce along with the withdrawal of state support and higher fixed costs, but to continue to remain above the 2019 average at EUR280bn (+EUR180bn or 1.2% of EU GDP). The improvement in their cash positions, along with very accommodative monetary policy well into 2021, should allow corporates to increase their total liquidity. Hence, companies are in a position to increase their investments during the recovery phase. Increases in net savings in 2020 are the highest in Italy, the UK and France (see Figure 4). We think digitalization of production processes, realignment of value chains, as well as improving distribution would be in focus. But this will be dependent on renewed confidence in a lasting restart of growth in Europe.

For that, (economic) policy decisions over the next few months will be decisive and will carry more weight than usual. Public support to reduce companies' fixed costs (lower social contributions, lower corporate taxes and/or fiscal incentives to invest) will be key, otherwise corporates might focus on protecting their cash flow which could also go through layoffs in order to reduce costs linked to wages. This would reduce future investments and/or dividend payments, raising the risk of the recovery fizzling out before pre-crisis levels of wealth and prosperity are reached. Expanding the state guaranteed loan schemes into H1 2021 could also be supportive for future company investment.

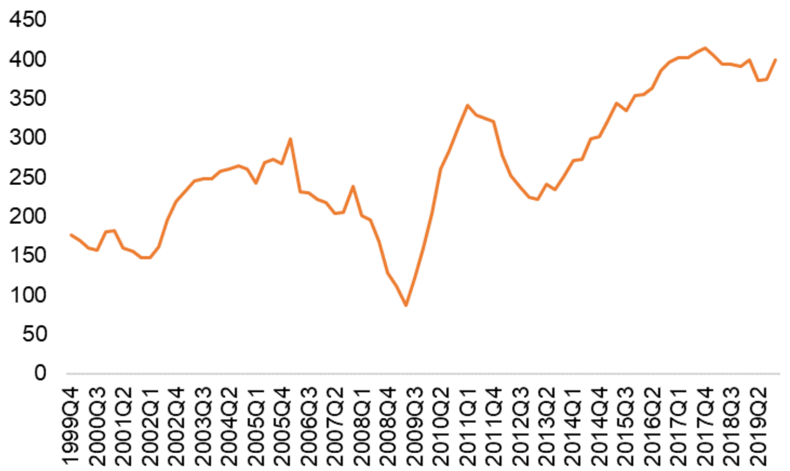
Figure 1 – Estimates of non-financial corporations' accounts by quarter

	2000-08	2009	2010-18	2019	2020Q1	2020Q2	2020Q3	2020Q4	2020
Gross value added	4%	-7%	3%	4%	-5%	-20%	5%	15%	-10%
Compensation of employees	4%	-5%	3%	4%	-10%	-30%	20%	30%	-6%
Gross operating surplus (EBITDA, change)	5%	-10%	3%	3%	0%	-13%	-14%	-12%	-15%
Current taxes on income, wealth, etc.	6%	-32%	4%	3%	-20%	-50%	20%	40%	-24%
Gross savings (EURbn)	1207	1310	1691	1996	792	713	595	494	2594
Net savings (cash provided by operating activities, EURbn)	212	160	320	399	386	327	201	81	995

Sources: Eurostat, Euler Hermes, Allianz Research

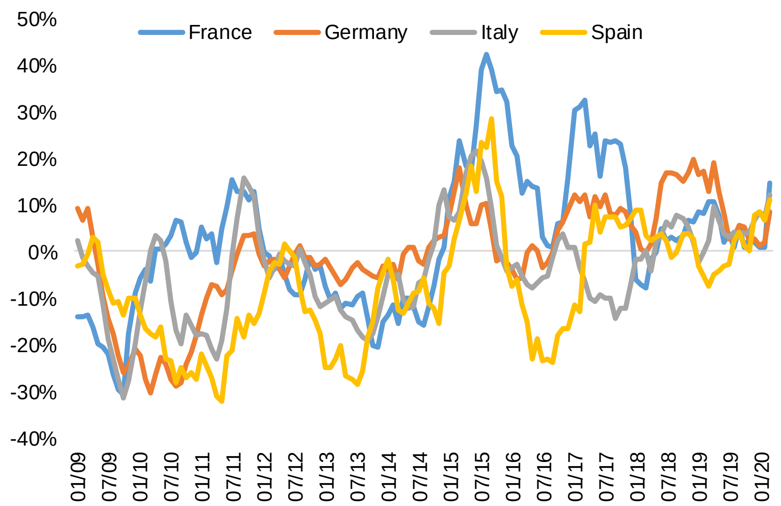
Definitions: 1/ Sales – Intermediate consumption = Gross value added – Compensation of employees – Net interest paid – Net dividend paid – Taxes = Corporate savings (or gross savings) = Investment + Net amortization of securities + Net acquisition of securities + Net increase in bank deposits; 2/ Net savings = gross savings – consumption of fixed capital (capex)

Figure 2 – Net savings of EU non-financial corporations, EURbn, 4Q sum



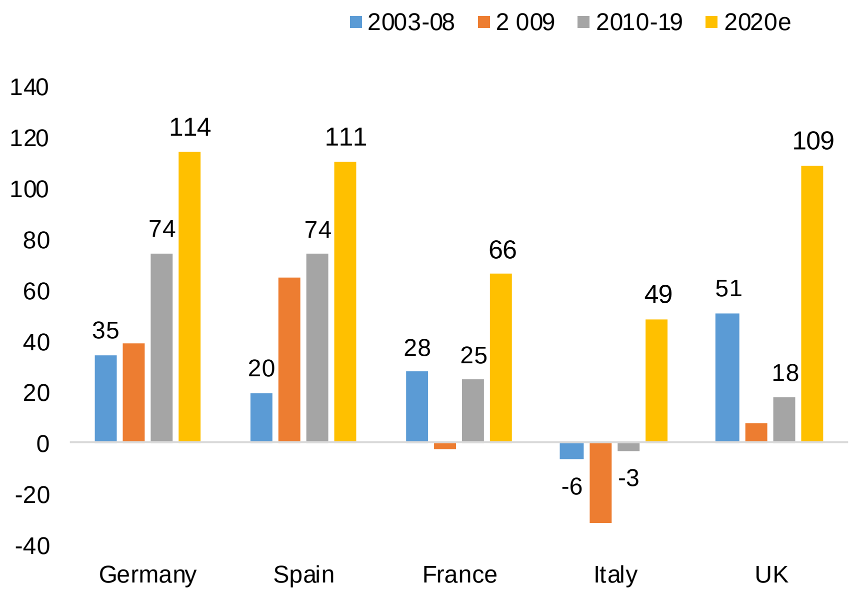
Sources: Eurostat, Euler Hermes, Allianz Research

Figure 3 – New bank loans to non-financial corporations, y/y



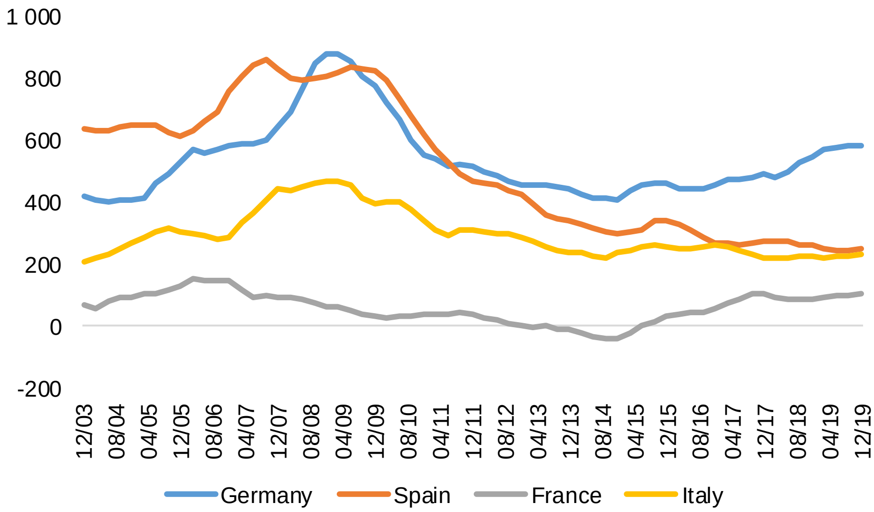
Sources: ECB, Euler Hermes, Allianz Research

Figure 4 – Annual net savings by country, EURbn



Sources: Eurostat, Euler Hermes, Allianz Research

Figure 5 – Estimate of non-financial corporations' excess cash, i.e. net savings + new banks loans – gross fixed investment (EURbn)



Sources: Eurostat, Euler Hermes, Allianz Research

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