ANALYSIS

Moderate growth in Finnish companies' non-performing loans

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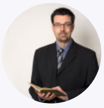

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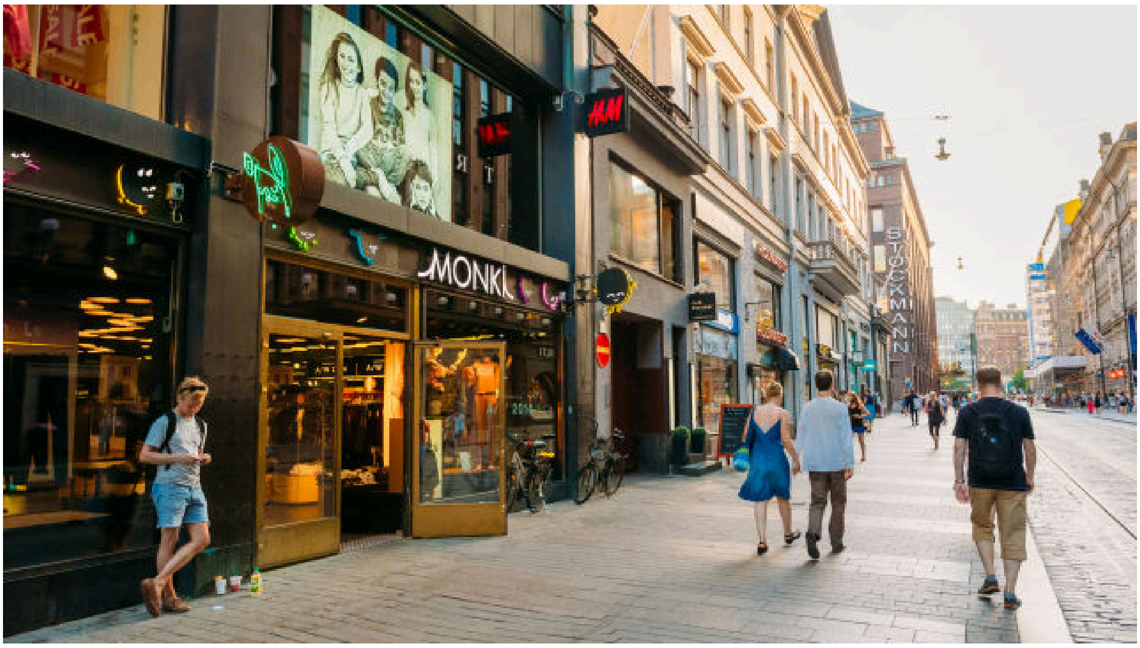
The economic shock caused by the COVID-19 pandemic has reduced demand for goods and services offered by Finnish companies. Accommodation and catering services, in particular, have faced severe difficulties. The risks of corporate loans to banks and other corporate lenders have increased. The heightened risk has not, however, been reflected much in the average interest rates on new corporate loans from banks. So far, no significant amounts of credit losses have incurred from corporate loans, but payment-term arrangements have been used extensively.



The COVID-19 pandemic drove the Finnish economy into recession in 2020 and has created great uncertainty about the future development of the economy. Economic crises pose a threat of widespread problems in the corporate sector, which at worst may lead to bankruptcy waves and a sharp rise in unemployment. In addition to the duration of the crisis and the support measures targeted at the corporate sector, companies' ability to cope with the coronavirus crisis will be affected by factors such as the ability of the banking sector to transmit new financing to them, the terms of new and renewed financing, banks' chances to cope with impairments and credit losses, and the indebtedness of companies.

Economic crises pose a threat of a "credit crunch". In a credit crunch, banks suffer major credit losses and their lending capacity is weakened: the financial system is unable to provide financing to financially sound companies, as financial institutions are forced to limit their lending to maintain their solvency. This occurred, for example, in the Finnish economic and banking crisis in the early 1990s and in many European countries during the worst stages of the global financial crisis and the euro area sovereign debt crisis in 2008–2009 and 2010–2012. Even in Finland, the global financial crisis caused big corporations to return to domestic banks for funding, which temporarily threatened to halt small enterprises' access to financing in late 2008 and early 2009.[1]

The operating conditions of banks have been significantly strengthened through extensive regulatory reforms since the global financial crisis. The aim of the reforms has been to secure a strong banking sector that is able to provide funding also in difficult economic conditions.

This article assesses the development of the availability and conditions of bank loans for Finnish companies and the extent of problems related to the servicing of bank loans during the COVID-19 pandemic, in particular in the light of the Bank of Finland's statistics on financial institutions.

Some sectors hit hard by the coronavirus

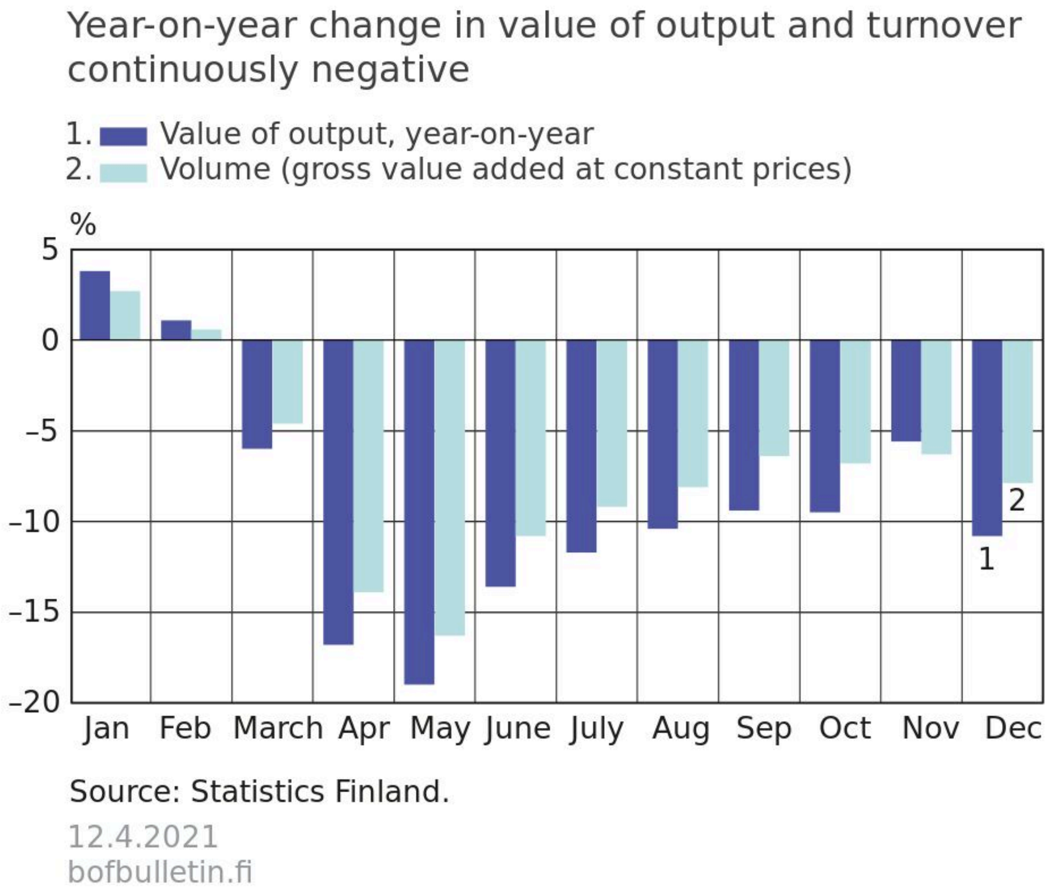
Like other countries, Finland has curbed the spread of the coronavirus through direct restrictions and recommendations issued by the authorities. Many restrictions have prevented companies from operating in part or even in full. In addition, increased consumer caution has reduced the demand for services involving a risk of exposure to the viral infection. By declaring a state of emergency and introducing containment measures in March 2021, Finland curbed the resurgent spread of the virus, but also further delayed and hampered the recovery from the crisis of companies affected by the pandemic.

The coronavirus has affected different sectors differently. Many of the restrictions have been targeted directly at companies in the restaurant and tourism industry. According to the business outlook indicator calculated by the Finnish Hospitality Association MaRa, the economic outlook for the sector has been significantly bleaker than normal since spring 2020. In March 2021, restaurants were closed in most parts of Finland and only allowed to serve takeaway meals. The restrictions have further worsened the situation for restaurants.

In accommodation services, the situation is also very precarious. According to Statistics Finland, between March 2020 and January 2021, the number of overnight stays of foreign tourists was almost 85% lower than a year earlier. The number of overnight stays of Finnish customers decreased by around 30%.

The turnover of companies in the services sector declined sharply in spring 2020 and has continued to decline since then (Chart 1). According to Statistics Finland, turnover of companies in accommodation and food service activities fell by more than one quarter from the previous year in January–October 2020. In the same period, turnover in transportation and storage activities declined by about one fifth.

Chart 1.



A business survey conducted by Finnish Industry Investment, for example, provides an indicative overview of company and sector-specific differences in profitability growth during the COVID-19 pandemic.[2] Measured in terms of the profit share of Finnish SMEs, average profitability did not deteriorate in 2020, at least not in the second and third quarters.[3]

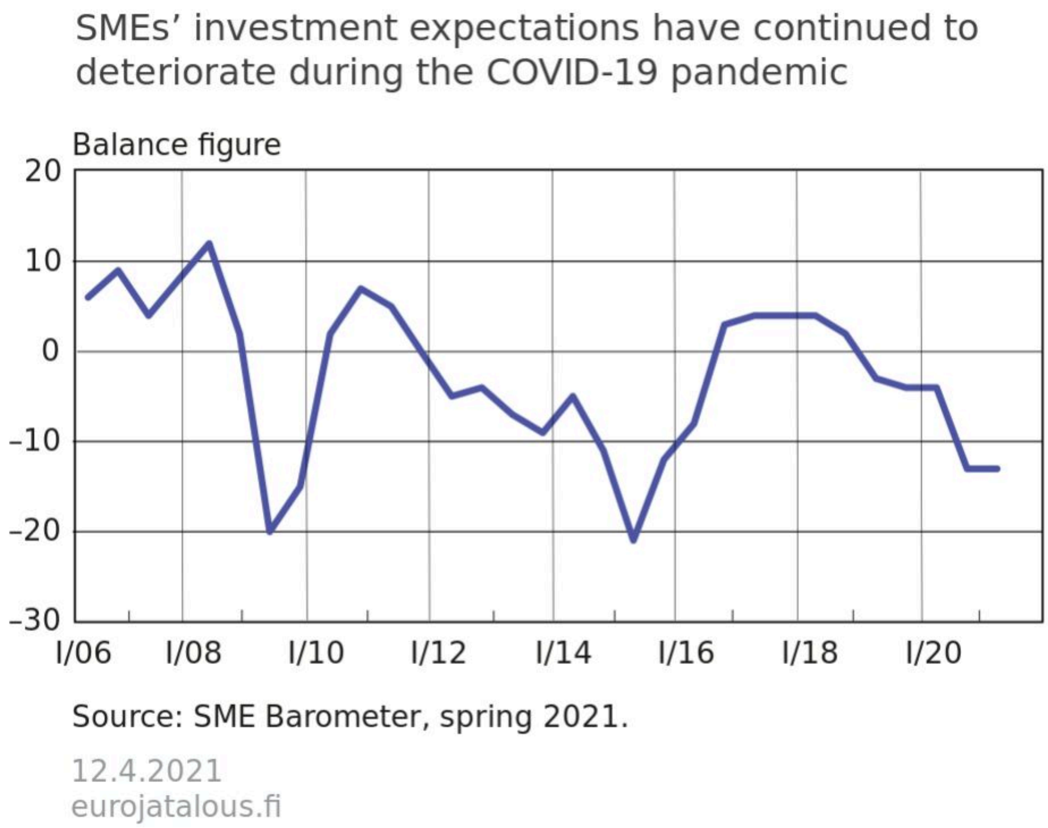
Nonetheless, the survey showed that there are great differences in the profitability of different companies and sectors. Around one tenth of the companies who responded to the survey estimated that their profitability measured by operating profit will decline by at least one quarter in 2020. The profitability expectations of accommodation and catering companies clearly deteriorated most. At the same time, more than half of the companies estimated that their profitability has remained unchanged or even improved.

Coronavirus temporarily increased financing needs of companies in spring 2020

The effects of the COVID-19 pandemic on new corporate lending of Finnish banks are quite similar to the effects of the global financial crisis just over ten years ago. In both crises, the escalation led to a short-term increase in banks’ lending to companies, as companies affected by the contraction of their turnover and the depletion of their cash assets needed bank loans to meet their acute liquidity needs.

Also in both crises, new lending of banks started to decline rapidly after the early stages of the crisis, as companies began to postpone or reduce their investments in an exceptionally uncertain operating environment. According to the February 2021 SME Barometer published by the Federation of Finnish Enterprises, Finnvera and the Ministry of Economic Affairs and Employment, the number of companies expecting investment reductions still exceed those expecting growth in all the main sectors (Chart 2).[4]

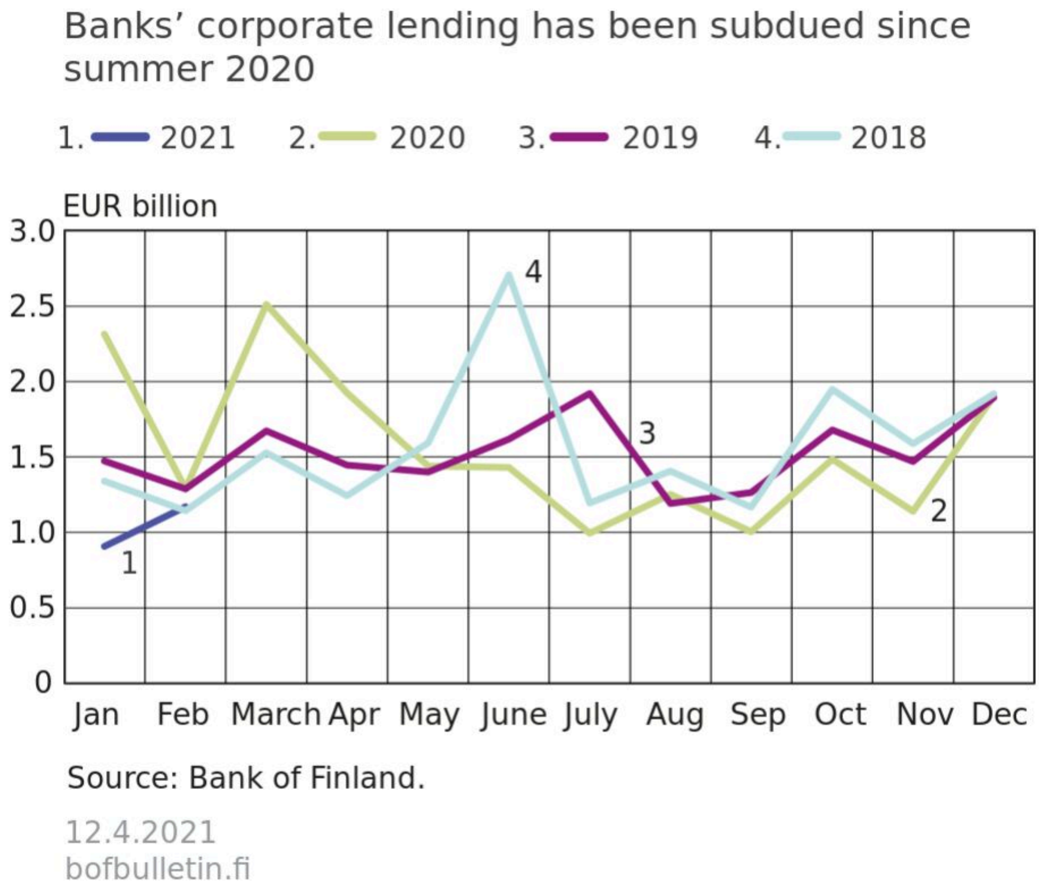
Chart 2.



In all of Finance Finland's Banking Barometer surveys conducted in 2020, bank managers expected demand for corporate loans to shrink.[5] Expectations were lowest in the second and fourth barometers of 2020 but, for example during the global financial crisis 2008–2009, bank managers' expectations of future demand for corporate loans were even lower.

The use of external financing from monetary financial institutions (MFIs) increased rapidly in Finnish companies in March–April 2020, as the containment measures introduced to control the coronavirus and increased consumer caution reduced the demand for products and services in many sectors. Statistics by the Bank of Finland show, however, that since May 2020, the monthly volume of new corporate loans granted by Finnish MFIs has been on average significantly lower than in 2018 and 2019 (Chart 3).

Chart 3.

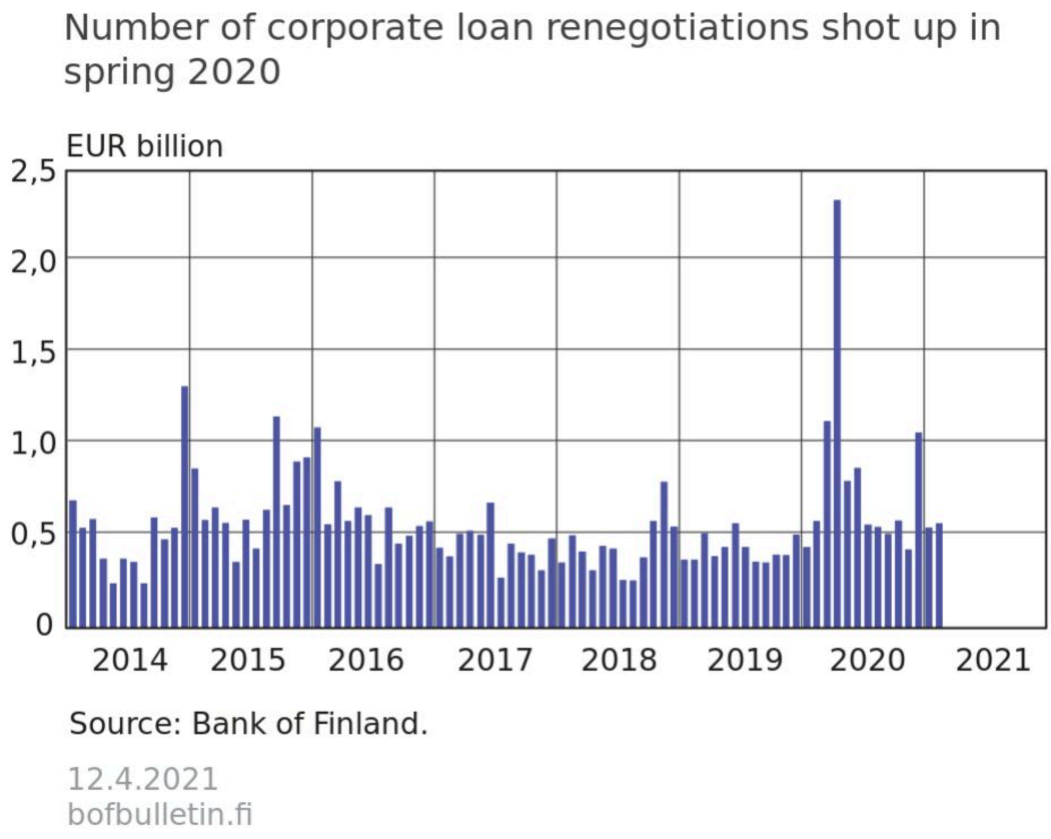


MFI loan statistics do not show the numbers of rejected loan applications or instances where a company decided not to apply for a loan due to the likelihood of not receiving it. According to the SME Barometer 1/2021, problems with access to finance were not particularly exacerbated in December 2020 and January 2021: only 6% of SMEs reported that they had not applied for funding in the last 12 months despite a need for it. Additionally, only about one in ten of those who decided not to apply reported that the reason was poor access to funding.

But while access to funding may be good on average, it may also conceal sectoral difficulties. According to the Finnish Hospitality Association MaRa's cyclical barometer of January 2021, at least in the tourism and restaurant sector, companies have struggled with significant financial difficulties.

In order to mitigate the shock caused by the COVID-19 pandemic, in early spring 2020 companies applied for an exceptionally large number of interest-only periods and other changes in their loan payment programmes (Chart 4). The number of changes to payment programmes granted by banks was also clearly higher than normal in December 2020. According to the Financial Supervision Authority, about 5% of the corporate credit portfolio of Finnish banks was subject to interest-only periods and other allowances in repayment arrangements in August 2020. At the end of 2020, the share had decreased to slightly over 2%.[6]

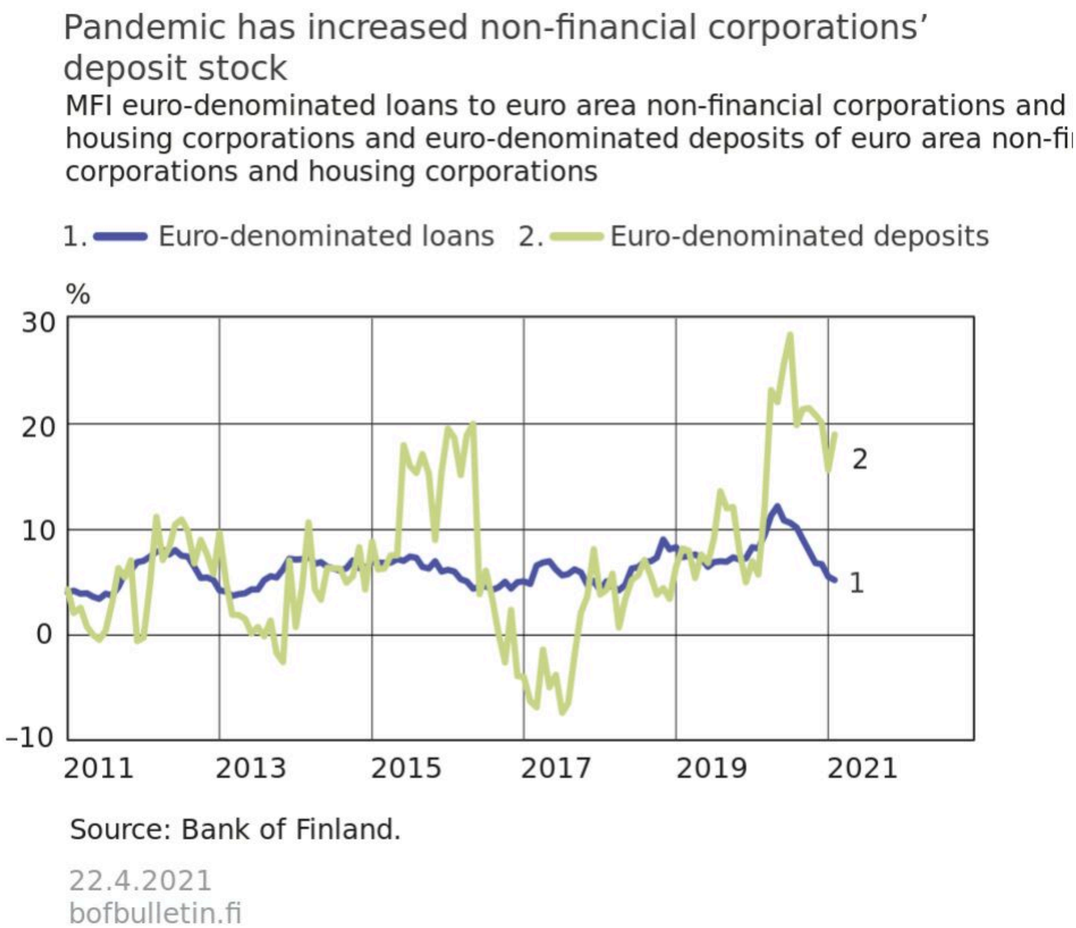
Chart 4.



According to statistical data collected by the Bank of Finland, between March and December 2020, renegotiated loans to accommodation and catering companies totalled EUR 264 million, which corresponds to approximately 34% of the sector's bank loan stock in March 2020. In other sectors, the share of renegotiated loans has been smaller. In manufacturing, for example, renegotiated loans in the same period represented only around 15% of the loan stock in March 2020. The aggregate amount of renegotiated corporate loans in all sectors totalled nearly EUR 9 billion, which is roughly 15% of the March 2020 loan portfolio.

On the other hand, the decline in companies' borrowing and investment appetites has led to strong growth of the corporate deposit stock (Chart 5). In economic crises, uncertainty increases demand for money, as different economic agents typically want to keep a larger share of their assets immediately available, for example in current accounts or as assets with high liquidity.

Chart 5.



No new sector-specific risk premia on corporate loans

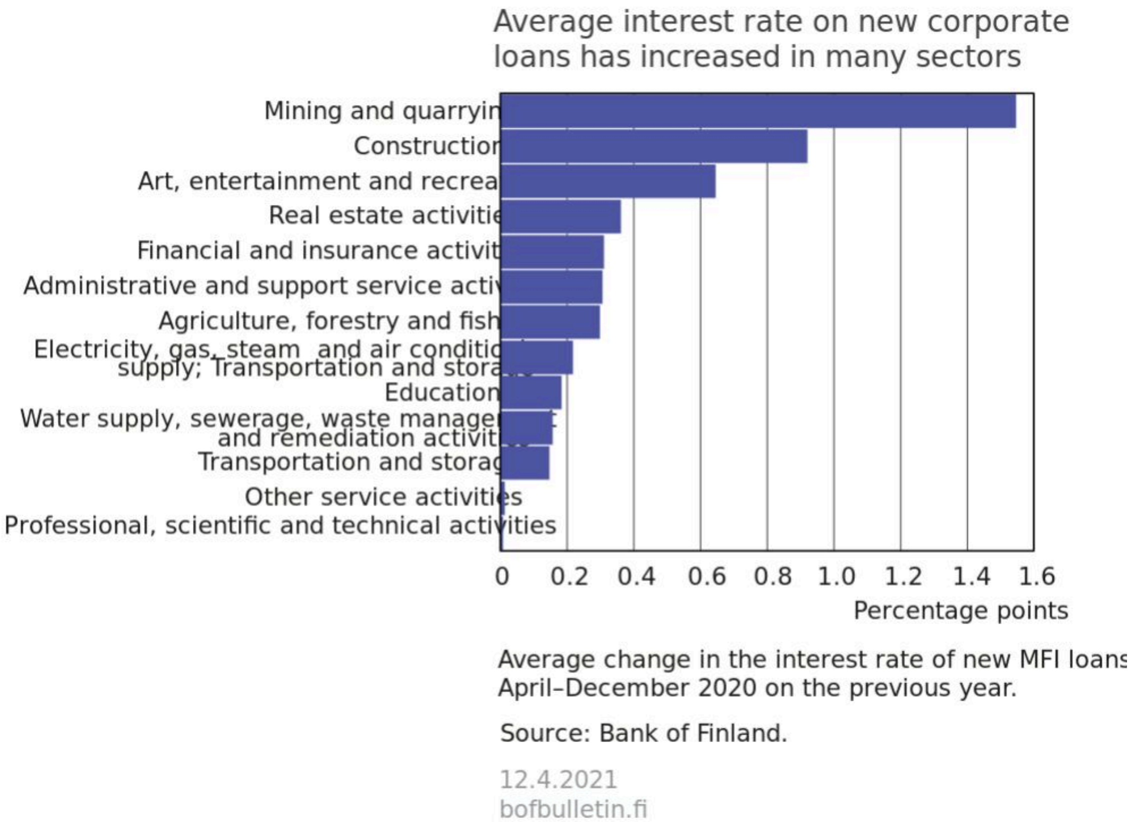
The credit risk associated with the repayment of the loan usually affects the interest rate of the loan, because the creditor takes the risk into account in the loan terms and in the decision to approve the credit application.[7] Lenders compete for low-risk debtors by offering low interest rates, which means that loan applicants assessed as reliable can obtain loans on cheaper terms.

Based on the average interest rates on new corporate loans, banks do not seem to have demanded higher interest rates from their corporate customers due to the potentially increased credit risk. In the last three quarters of 2020, the average interest rate on new corporate loans was around 0.3 percentage points lower than one year earlier. At the same time, the three-month EURIBOR was on average about 0.06 percentage points lower than a year earlier, so reduced corporate loan prices cannot be fully explained by the fall in market rates. Either the credit risk in new business loans has not increased significantly, for example due to government support measures, or the increased risks may have affected the availability of credit or loan terms other than margins instead of interest rates.[8]

When interpreting the figures, it is important to note that companies that applied for loans in 2020 may have been more solvent or profitable than companies that received loans in 2019, or that the lending appetite or access to credit of companies with a poor credit rating may have decreased in 2020. The data may therefore contain only few new loans to weaker companies.[9] If these factors exist and their effects are prominent, they may make it more difficult to detect a possible increase in risk premia for corporate loans.

Industry-specific figures likewise do not indicate an increase in the average risk premia for new corporate loans by banks. A comparison of industry-specific average loan interest rates in April–December 2020 and 2019 does not show a correlation between interest rates and changes in turnover. From 2019 to 2020, the average interest rate on new loans increased most in the mining and quarrying industry, where the average interest rate on loans increased by 1.6 percentage points on the previous year. Arts, entertainment and recreation are particularly affected by the crisis, and the average interest rate on new loans increased by around 0.7 percentage points (Chart 6). On the other hand, the average interest rate on new loans for the most severely affected industry, accommodation and food service activities, surprisingly decreased slightly, by around 0.13 percentage points.

Chart 6.



Worst fears of Finnish companies' liquidity shortages and banks' large credit losses of banks have been allayed

The immediate impact of COVID-19 on the Finnish economy has been less severe than predicted in the most adverse scenarios. Through measures such as direct support to companies and a temporary amendment to the Bankruptcy Act[10], Finland has so far avoided the feared wave of bankruptcies. Unlike some previous economic crises, the coronavirus crisis has not, at least not yet, undermined the loss-bearing and lending capacity of the Finnish banking sector, which were strengthened through regulatory reforms before the onset of the crisis.

If the Finnish economy recovers from the pandemic as predicted, it appears that the darkest scenarios presented in spring 2020 on Finnish banks' credit losses[11] will remain unrealised. However, the development of credit losses is subject to uncertainty and typically materialised over a relatively long term.

Total non-performing loans increased by only around 8% in all industries between March and

December 2020. At the end of 2020, the industry with the relatively highest share of non-performing loans was human health and social work activities. Non-performing loans accounted for almost 8% of the sector's loan stock. Surprisingly, the difficulties in accommodation and food services were not reflected as a sharp increase in debt servicing difficulties, at least not during 2020: the amount of non-performing loans in this sector increased by less than EUR 10 million. Due to the low baseline, however, the percentage increase was high, approximately 23%.

Notes

1. See e.g. Bank of Finland Governor Erkki Liikanen's speech: The international economic crisis and Finland (in Finnish), Conference of Finnish venture capital investors 'Pääomasijoituspäivä', Helsinki, 3 February 2009 (suomenpankki.fi). ↑
2. See 20201208_Koronakriisin-vaikutukset-PK-yrityksiin_Kierros_3-FINAL-1.pdf (tesi.fi, in Finnish). ↑
3. Corporate profit share refers to the share of operating surplus in value added. ↑
4. See SME Barometer spring 2021, Yrittajat.fi (in Finnish). ↑
5. See Banking Barometer, Finance Finland. ↑
6. See Magnitude of effects of the COVID-19 pandemic vary between sectors – Finnish banks are well equipped to support economic recovery (in Finnish). ↑
7. It is also possible that, in order to cover the uncertainty of the loan, the interest rate would have to be so high that it would become difficult to service the loan. In such situations, the loan is unlikely to be granted or the offered loan is not drawn. ↑
8. According to the latest SME Barometer by the Federation of Finnish Enterprises and its partners, of the companies that estimated that banks had tightened their lending policies, around two thirds reported that collateral requirements had tightened, whereas one third reported that loan margins had widened. SME Barometer spring 2021, Yrittajat.fi (in Finnish). ↑
9. According to a business survey conducted by Finnish Industry Investment, only a relatively small number of companies whose solvency has deteriorated significantly due to the pandemic have applied for a new bank loan, see 20201208-vaikutukset-PK-yrityksiin_Kierros_3-FINAL -1.pdf (tesi.fi, in Finnish). ↑
10. Between May 2020 and January 2021, the amendment temporarily removed the presumption that a debtor who has not repaid a clear and due claim within a week of the receipt of a remainder shall be deemed insolvent. Creditors could therefore not use a bankruptcy-threatened demand for payment as a means for recovering claims. The amendment was based on government proposal 46/2020 and was originally set to stay in force until the end of October 2020. ↑
11. For more information about scenario calculations by the Bank of Finland in spring 2020

on the impacts of the COVID-19 pandemic on the loan losses of Finnish banks, see Banks must be able to finance firms and withstand loan losses amid the coronavirus pandemic, Bank of Finland Bulletin. ↑

Key words

companies/firms, COVID-19, COVID-19 pandemic, financing