EU CORPORATES AND COVID-19: THE SHORT AND LONG TERM CHALLENGES

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Covid-19 economic crisis – EU corporates

• A massive economic shock:
  • Lockdown as a massive shock across geographies and sectors
  • Demand and supply shock, trade collapse and questioning on GVC model

• Rebooting in the face of sectoral, country, regional and firms heterogeneity

• Huge uncertainty remains:
  • Medical (immunization, timing for a vaccine, second round of contagion, etc.)
  • Shape of the recovery (effectiveness of policy answers and consequent likelihood/severity of second round effects of the crisis)
  • Long term structural changes (change in individual preferences, labor market, value chains security, role of the state)
Corporates – a sizable impact on EU corporate sector

- After 3M of lockdown, 51-58% firms might face liquidity shortfalls, despite discounting for policy intervention

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<tr>
<th></th>
<th>1 month</th>
<th>2 months</th>
<th>3 months</th>
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<tbody>
<tr>
<td></td>
<td>Share (%)</td>
<td>Shortfall</td>
<td>Share (%)</td>
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<tr>
<td>Policy support</td>
<td>26% 29%</td>
<td>46 0.3</td>
<td>46% 50%</td>
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<tr>
<td>Heightened policy support</td>
<td>19% 21%</td>
<td>14 0.1</td>
<td>38% 43%</td>
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Source: ORBIS\textsuperscript{ii} and EIB calculations. Note: Based on EU27. The columns "Share" indicates the proportion of corporates that do not have enough cash to withstand their payment obligations over the period, as % of the population (1st column) and of value added (2nd column).

- Normalisation will take time. The cumulative loss in net revenues for the corporate sector might amount to 13% - 24% of GDP
Corporates – resilience dependent on size. For all firms, in the medium term, a trade off between investment and leverage emerges.

- Investment decline: 31 to 52%
- Higher leverage 6% vs 4% of GDP, depending on strategic choices

**Figure 12: Interval of net revenues reduction by size of corporation (median, % of total assets)**

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<tr>
<th></th>
<th>SMEs</th>
<th>Large</th>
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<tr>
<td>12%</td>
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<td>9%</td>
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<td>6%</td>
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<td>3%</td>
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Source: ORBIS and ECON calculations.

**Fig 9 – Filling the gap: impact on investment and indebtedness (% EU economy)**

- Cash reduction and normal external financing
  - Cash buffer
  - Reduction in investment
- Cash reduction and stronger recourse to external financing
  - Increased indebtedness

Source: ECON computations based on EUROSTAT and ORBIS. Results under the baseline scenario.
Optimal policy sequencing

- In the recovery phase, at the firm level strategic choices:
  - Reduce investment
  - Increase debt
- Need to keep focus on innovation and diffusion of innovation, as well as climate
- At the economic level: preserve, but adapt and transform fast

- Drop in revenues and fix costs
  - Cash buffers depleting fast, particularly for SMEs
- Rebates and grace periods
- Liquidity and credit (and guarantees)
- Equity and equity type instruments
- Lock down
- Unlocking and recovery
- Long term
Conclusions

• The Covid19 crisis strongly affect firms

• Liquidity shortfall and long term-strategic trade-off emerging: leverage vs investment

• Optimal sequencing of policy intervention
  • Grace periods
  • Access to credit and guarantees
  • Complemented by equity type of instruments
  • Long term focus: climate and innovation

Digital adoption:
EU 58% vs US 69%

Investment in EE:
EU 40% vs US: 47%

EU firms: 13% of the group of new top innovators (vs US 34%)

VC/GDP: EU 0.05%
vs US 0.33%

80% firms in the lowest productivity group stuck for at least 3Years
ANNEX - Corporates – a sizable impact on EU corporate sector

- An accounting exercise with balance sheet and profit and loss figures for 1.4 mn firms in Europe (Eur 8 tn)
  - Simulate the drop in revenues and stickiness of costs (distinguishing by different costs)
  - Simulate the policy intervention (grace periods and rebates)
  - Assume different “business normalization” scenarios

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<tr>
<th>Table A2 – Calibrations used</th>
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<td>Policy support during lockdown</td>
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<td>Heightened policy support during lockdown</td>
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<td>Recovery period fast, 3 months</td>
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<td>Recovery period slow, 6 months</td>
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