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By Grzegorz Sielewicz,
Coface Economist for
Central & Eastern Europe,
based in Warsaw, Poland

Central & Eastern Europe Insolvencies: Good times come to an end

A favourable economic environment was not enough to reduce company insolvencies in Central and Eastern Europe (CEE). While average GDP growth accelerated to 4.5%, i.e. the highest level in nine years, insolvencies increased by 6.4%. This latter figure ends the improving trend in business insolvencies, which decreased in both 2015 and 2016. 2017 saw an increase in insolvencies proceedings in nine countries[1] and drops in only five[2]. The regional breakdown indicates a wide variety of dynamics, ranging from a 27.1% decrease in insolvencies in Slovakia, through to a slight increase of 2.4% in Estonia and a surge of 40.1% in Croatia.

These events are surprising, given that companies have faced the highest rate of economic expansion since 2008. Moreover, growth was balanced, with a strong contribution coming from rebounding fixed asset investments and household consumption, driven by low unemployment, soaring wages, and improved consumer sentiment. Funds from the new European Union budget fuelled public investments, and high capacity utilisation amid solid demand encouraged companies to expand. On the other hand, good economic times saw new businesses attempting to enter highly competitive environments. Companies often experienced an increase of turnover, but a limited increase of profits, which were constrained by growing costs, such as a gradual increase of wages and higher input costs, as confirmed in accelerating producer price indexes. The aforementioned rebound of fixed asset investments has been supportive for demand for construction; however, companies were not able to respond due to the rapid rise of building material costs and labour shortages[3]. Difficulties in fulfilling vacancies have become a major obstacle for businesses in the CEE region, according to Eurostat's business surveys.

The trend of increasing insolvencies illustrates the end of an economic cycle in the region. CEE countries reached a peak of their economic expansion last year and weaker growth is expected in 2018, followed by a further slowdown in 2019. Nevertheless, it is going to be a slight slowdown with no signs of recession mainly due to ongoing solid demand, although businesses will not be able to enjoy macroeconomic conditions as good as in 2017. Various supply constraints, high competition resulting in low margins or challenges coming from foreign markets where an increased level of protectionism is anticipated affect on businesses in the CEE region. As large companies will be able to take advantage of their negotiating power and a wide presence, insolvencies will mostly apply to smaller entities. Our forecast (based predominantly on GDP growth expectations) assumes that company insolvencies in the CEE region will increase by 10.4% in 2018 and 15.5% in 2019.

1 - Croatia, Estonia, Hungary, Lithuania, Poland, Romania, Russia, Serbia, Slovenia
2 - Bulgaria, Czech Republic, Latvia, Slovakia, Ukraine
3 - Construction companies were widely represented in insolvency statistics across the CEE region.