Reflections on the impact of the COVID-19 crisis in Germany, Poland and Italy

Representatives from the same firm in three jurisdictions compare and contrast their experiences in the current crisis in respect of help available from local governments

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In this article we reflect on how the COVID-19 crisis has affected local economies and businesses in Germany, Poland and Italy considering whether support from governments has helped protect against business failure, which sectors have been hardest hit and which have prospered, as well as the impact of a second wave and what the future might hold.

What impact has the COVID-19 crisis had on the economy?

In **Germany**, the pandemic caused a historic decline in economic output seeing an unprecedented drop of 10.1% in gross domestic product (GDP) during Q2 of 2020. It is not surprising that both Polish and Italian economies were also heavily impacted, with public debt growing by 8% in Poland and the Italian ministry of economics predicting that GDP will drop by 10.5% in 2020. It is expected that the public sector deficit in Poland in 2020 will peak at 12% of GDP, equivalent to PLN 267 billion!

Italy, one of the countries hardest hit by lockdown measures during the first wave, reported that GDP in the first half of the year, was 12% lower than in the same period in 2019 and that by April industrial production was more than 40% lower than at the beginning of the year.

However, all three countries saw signs of recovery when restrictions were eased, with GDP rising in Germany by 8.2% in the Q3 of 2020 (although 4.2% lower than the last quarter of 2019). Italy also saw signs of partial recovery. In the third quarter, the return to growth was more robust than expected, driven largely by recovery in the industrial sector which, in August, returned to levels of activity comparable to those before the pandemic.

Have businesses managed to weather the first wave storm?

Largely yes, but perhaps the full impact is yet to be seen. The resilience of **German** businesses to the challenges posed by the COVID-19 crisis was possible thanks, in part, to the unprecedented €130 billion aid package offered by the German government seeking to prevent insolvencies, mass layoffs and a rise in poverty. Low-interest loans to companies, an expansion of wage subsidies for furloughed workers and state aid for large corporates have all lessened the financial impact. There is perhaps more optimism than expected among companies, but a certain level of pessimism as to what the future might hold still persists.

The **Italian** experience is similar. The government's anti-crisis measures and guaranteed financing helped mitigate the impact of the lockdown. However, recourse to new loans, also thanks to public guarantees, has increased indebtedness. As a consequence, Italy is likely to see increasing numbers of insolvencies.

In **Poland**, although almost all businesses were affected, most have managed to weather the storm. Surprisingly, like Germany and Italy, there has not been a record number of bankruptcies, probably due to the unprecedented government support packages.

Has government support helped protect against failure?

As already noted, the support from all governments seems to have helped most businesses weather the storm of the first wave.

The **Polish** government is said to have spent PLN 300 billion (approx. EUR 67 billion) to counteract the pandemic, including providing direct support of PLN 150 billion (approx. €33.5 billion) in the midst of the crisis. The financial support, coupled with new legislation introducing a moratorium in April 2020 (effectively suspending the obligation to file for bankruptcy) and further legislation in June 2020, giving businesses the option to use a simplified ['insolvency'] process allowing for out-of-court arrangements initiated by the debtor, have seemingly helped prevent significant business failures.

The **German** government also took decisive, vigorous and targeted action to protect the country, offering the largest financial assistance in the history of the Federal Republic. The €130 billion package in particular offered support to employees, the self-employed and businesses. Notably, the furlough scheme, known as Kurzarbeit, (extended until December 2021) is helping companies avoid layoffs, keeping staff on standby until the economy picks up again.

Support measures adopted by the **Italian** government between March and August 2020, included increases in public expenditure, tax reductions and credit support measures costing approximately Euro 100 billion (6.1% of GDP). The Central Bank of Italy ('CBI') has estimated that the main support measures implemented by the government have strongly mitigated the effects on liquidity and the capital of companies, based on an analysis of 270,000 joint-stock companies. According to that analysis, government measures have reduced, albeit not eliminated, the major liquidity deficit and the worsening of financial conditions.

Which sectors have been hardest hit or seen an uptick in profitability?

The automotive sector and machinery and plant engineering - two of **Germany's** key industries – were hardest hit by the pandemic. The German Automotive Industry Association warned already in June that around 100,000 jobs were at risk due to enduring low demand. However, the sector did see an output rise by 10.0% in September after a decline of 10.3% in August. In addition, the travel industry remains devastated, with 88% of travel and tour operators, as well as 71% of hotels, on Kurzarbeit.

Many manufacturers and suppliers in Germany have had to close down their plants at least partially and stop their supply chains. The long-term effects of these measures are unpredictable. A vast majority of German experts expect particularly high defaults in corporate loans in the coming months. The willingness of banks to provide new loans for restructuring cases is also likely to decline further.

Not all sectors of the **Polish** economy have been equally affected. The highest increase in insolvency occurred in services (+42%), agriculture (+28%), transportation services (+10%) and manufacturing (+7%). However, commerce and trade held fast, as well as construction. Whereas in **Italy**, the sectors most impacted, during both the first and second waves of the pandemic, have been catering, culture (museums, cinemas, theatres), tourism (travel agencies, hotel, resorts) and the sport sector (amateur sports associations and clubs).

Not unsurprisingly, all countries have seen an up-tick in profitability for businesses operating in e-commerce, pharmaceuticals, hygienic products and food-delivery sectors.

Has there been, or is there expected to be an increase in insolvencies?

While some observers in **Germany** forecast an increase in 2020 and a decrease next year, others, (pointing to the fact that the requirement to file for insolvency has been temporarily waived until end of 2020), expect a decline at the end of this year and the emergence of a sizeable number of zombie enterprises next year. However, the German Bundesbank (ignoring the waiver) projects a rise both this year and the next, with a quarterly peak of 6,400 insolvencies to be reached in Q2 2021.

Regardless of the surprisingly small number of bankruptcies in **Poland** to date, experts forecast an increase in Q4 of 2020 and further into 2021 unless demand for goods and services is restored or the government will support the economy at the same level. A second lockdown that is still possible may completely change things, seeing, instead of the relatively low numbers now, a sharp increase in insolvencies.

According to the CBI, by the end of 2020 **Italy** is likely to see an exponential increase in the number of companies in

undercapitalisation conditions, the situation most likely to be a precursor to bankruptcy. The CBI estimates that at the end of 2020 there will be 12.4% of undercapitalised companies at a national level, compared to a pre-pandemic level of only 7.2% of undercapitalised companies – although much lower than may have been the case without government support.

What does the future hold?

The current global economic crisis is unique in its kind because the crisis consists of at least two kinds of economic problems: a reduction in production due to the disrupted global supply chains and an unprecedented demand shortfall as a result of lockdown.

While all countries saw signs of economic recovery when restrictions were lifted, it is clear that economies have not bounced back as initially hoped. The impact of a second wave of the pandemic and the possibility that a vaccine might be available in the foreseeable future make it difficult to predict the shape of economies and how quickly they might recover, but for the short term the position remains challenging for most businesses and sectors. ■

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