

Three comments on corporate debt markets in Europe

Huw Pill

Chief European Economist

Huw.Pill@gs.com

+44 20 7774 8736

Goldman Sachs International

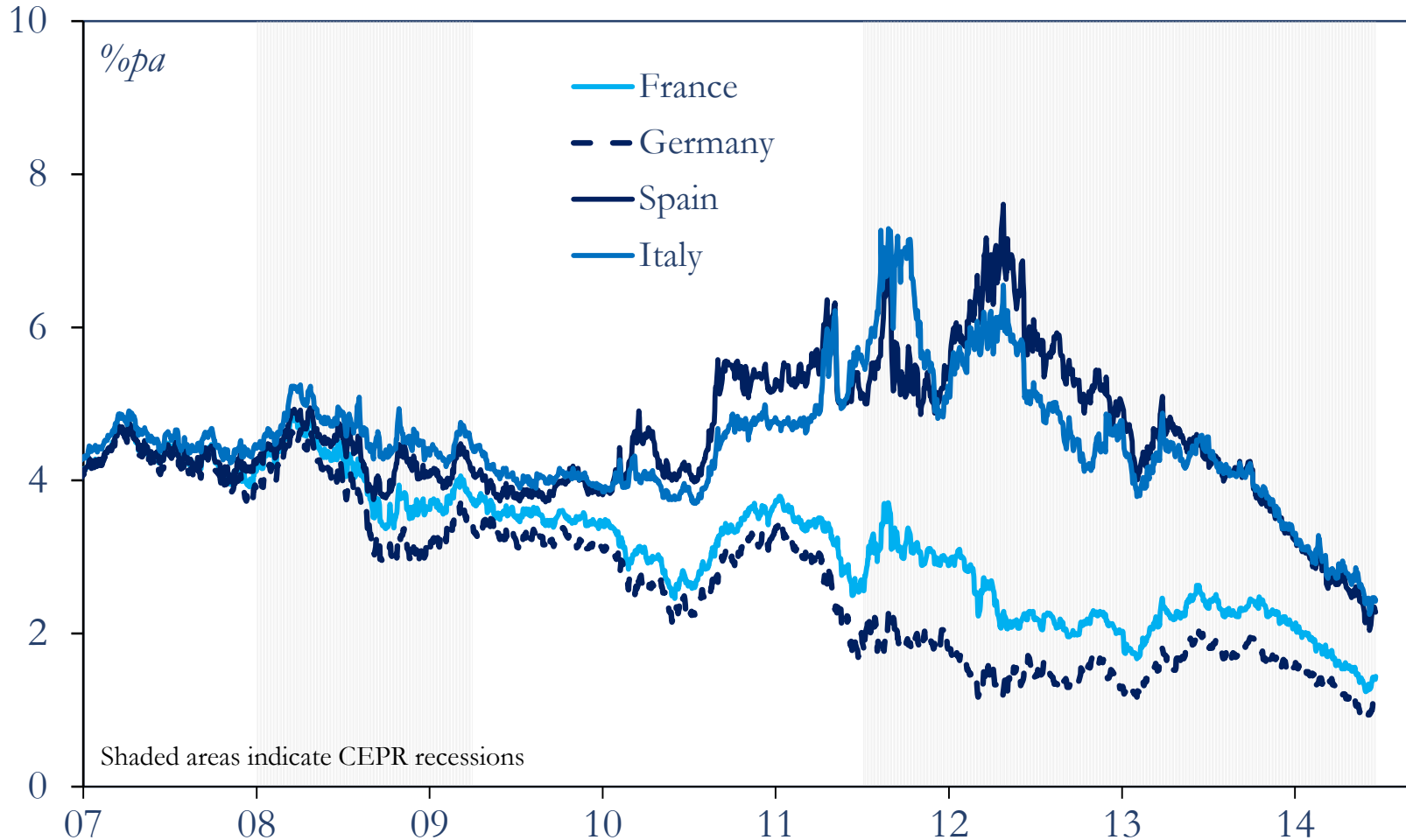
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The Past

Disruptions to corporate credit markets lie at the heart of the Euro area's economic under-performance during and after the financial crisis

Financial and sovereign crises disrupted Euro area markets



Source: Bloomberg, Goldman Sachs Global Investment Research

European banking markets fragmented during the financial crisis

2008 Q1

2012 Q1

Pre-Lehman, Euro interbank markets were highly integrated

With the financial crisis, segmentation has emerged

cross-border bank claims as a percentage of lending country GDP, 2008 Q1

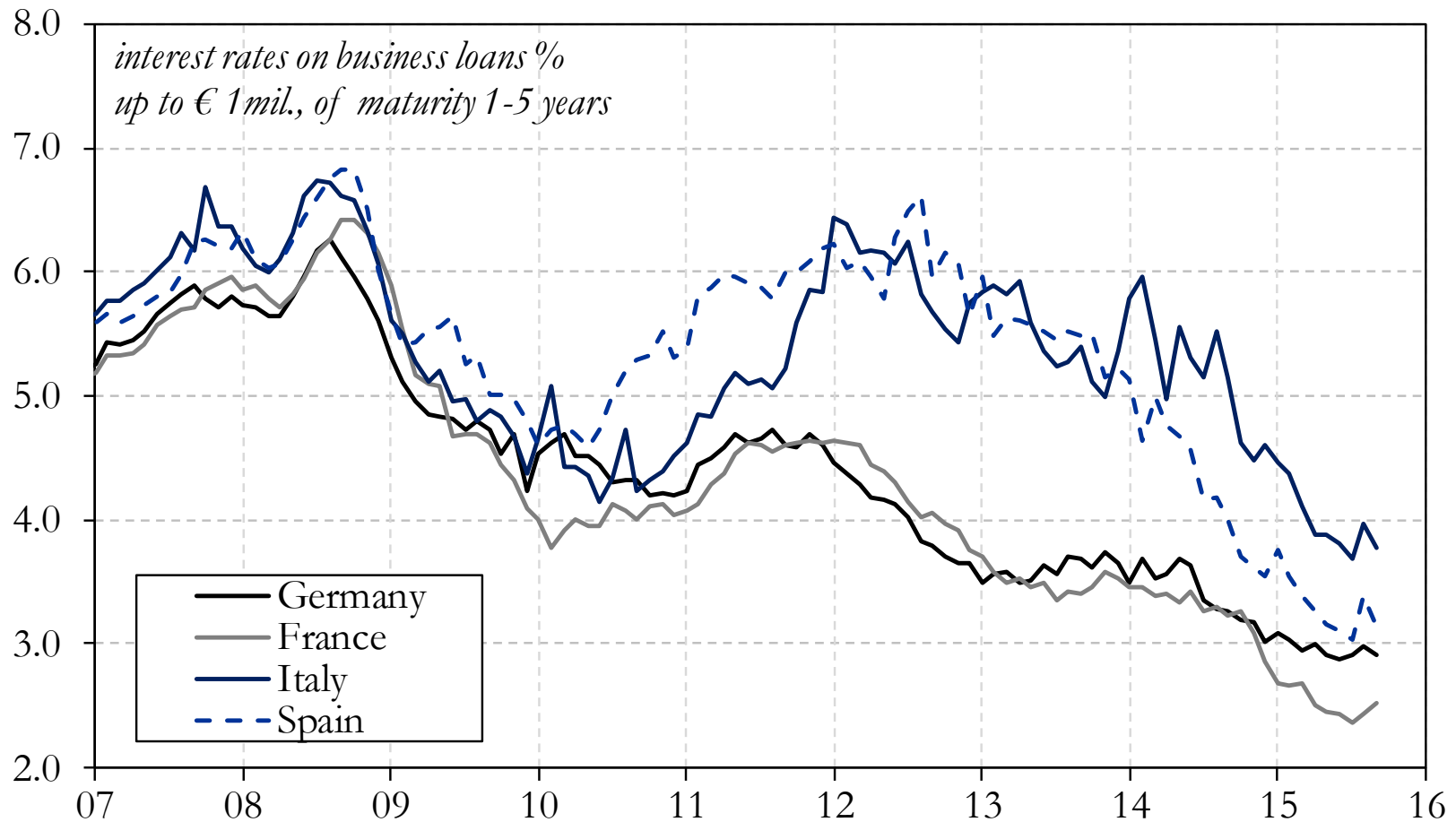
cross-border bank claims as a percentage of lending country GDP, 2012 Q1

	Ger	Ned	Fra	Ita	Spa	Por	Ire	Gre
Ger		30.0%	42.9%	44.4%	51.9%	8.3%	37.8%	7.4%
Ned	147.3%		134.9%	110.5%	90.7%	11.3%	34.6%	15.4%
Fra	64.4%	35.3%		119.8%	48.4%	7.6%	21.8%	16.7%
Ita	114.3%	9.9%	18.3%		8.6%	2.2%	8.8%	2.4%
Spa	22.9%	25.8%	25.5%	18.3%		33.9%	9.4%	0.5%
Por	18.5%	12.6%	15.7%	13.3%	79.2%		15.2%	18.0%
Ire	118.7%	45.0%	67.4%	122.0%	82.7%	11.5%		22.4%
Gre	3.3%	1.9%	2.9%	0.8%	0.2%	0.1%	0.8%	

	Ger	Ned	Fra	Ita	Spa	Por	Ire	Gre
Ger		27.2%	32.7%	22.0%	23.0%	4.5%	15.4%	4.4%
Ned	129.7%		53.6%	25.7%	47.9%	3.2%	13.8%	1.9%
Fra	45.8%	28.5%		72.9%	25.4%	4.5%	6.8%	7.7%
Ita	67.6%	5.5%	9.3%		6.9%	0.8%	4.4%	0.5%
Spa	23.2%	8.0%	15.9%	13.2%		31.9%	3.5%	0.4%
Por	6.2%	25.1%	19.4%	7.4%	52.0%		43.6%	18.8%
Ire	6.3%	5.3%	10.9%	2.7%	10.3%	1.1%		0.3%
Gre	5.1%	7.1%	3.9%	0.8%	0.5%	0.1%	0.9%	

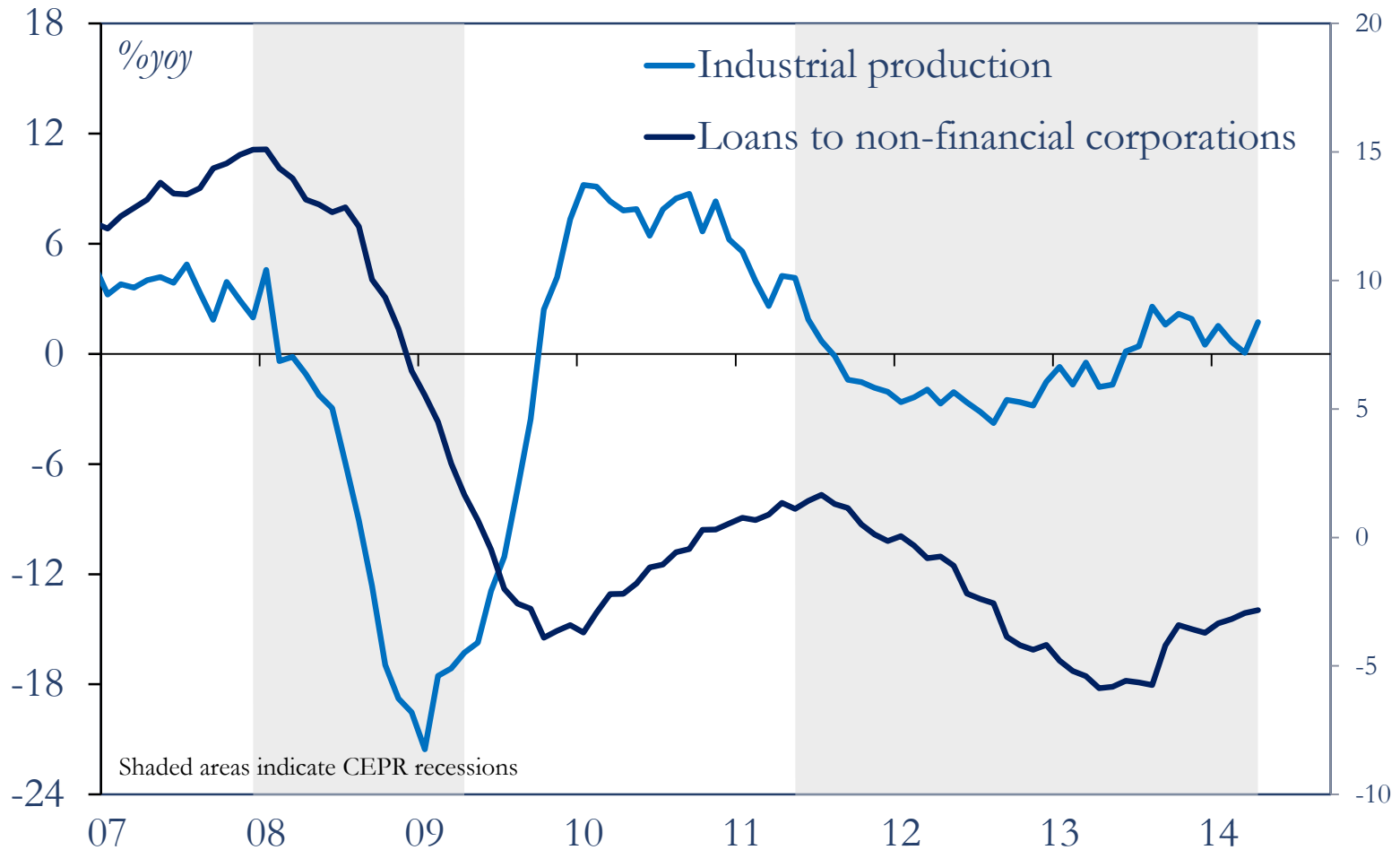
Source: BIS, Goldman Sachs Global Investment Research

Bank lending rates showed significant cross-country dispersion within the Euro area



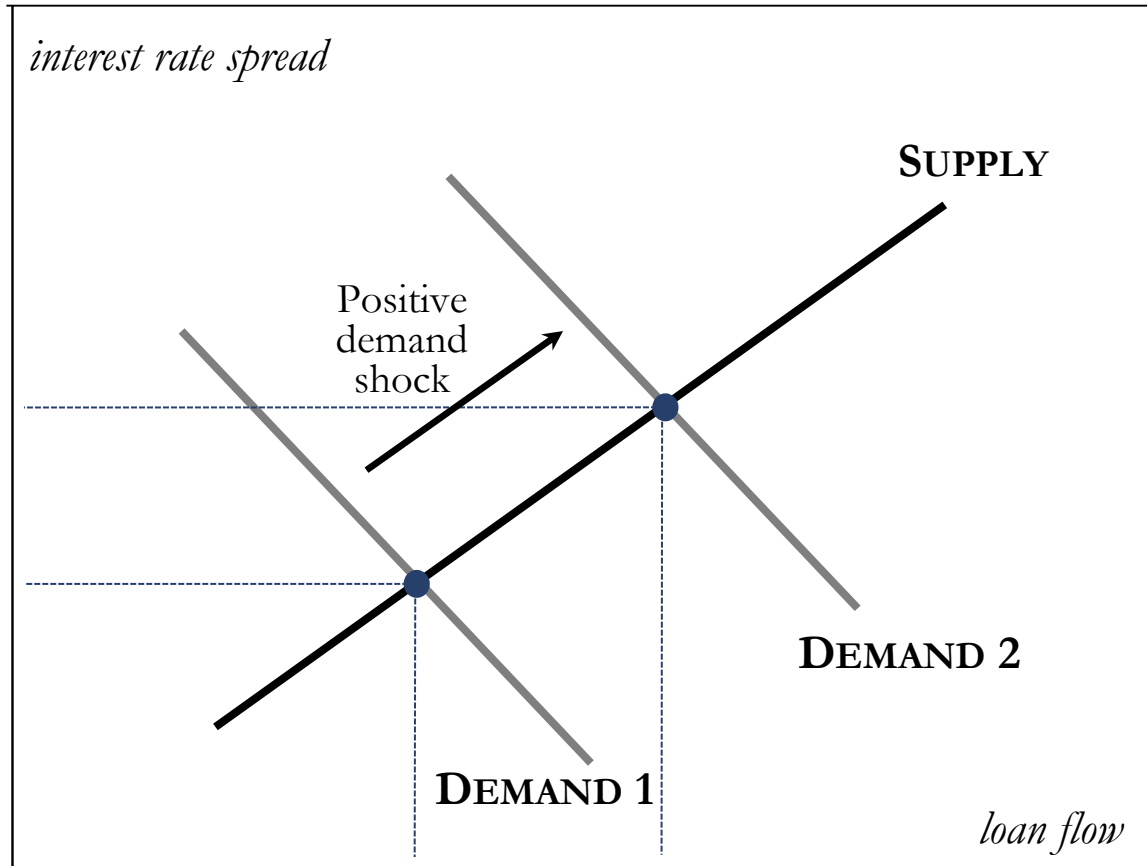
Source: ECB

European banking markets fragmented during the financial crisis



Source: ECB, Eurostat, Goldman Sachs Global Investment Research

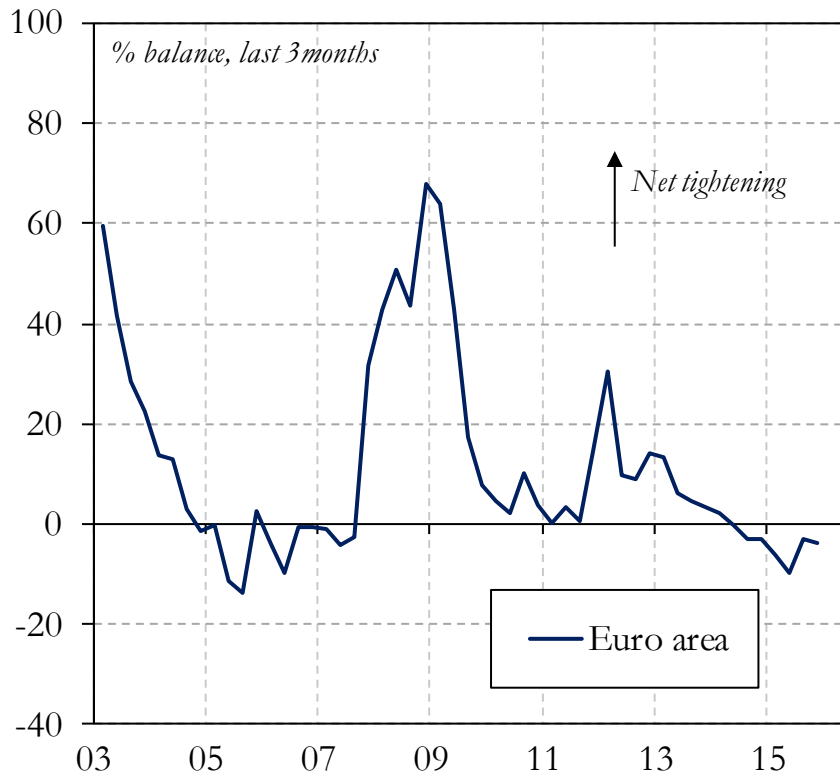
A (trivial) demand / supply framework ...



Source: Goldman Sachs Global Investment Research

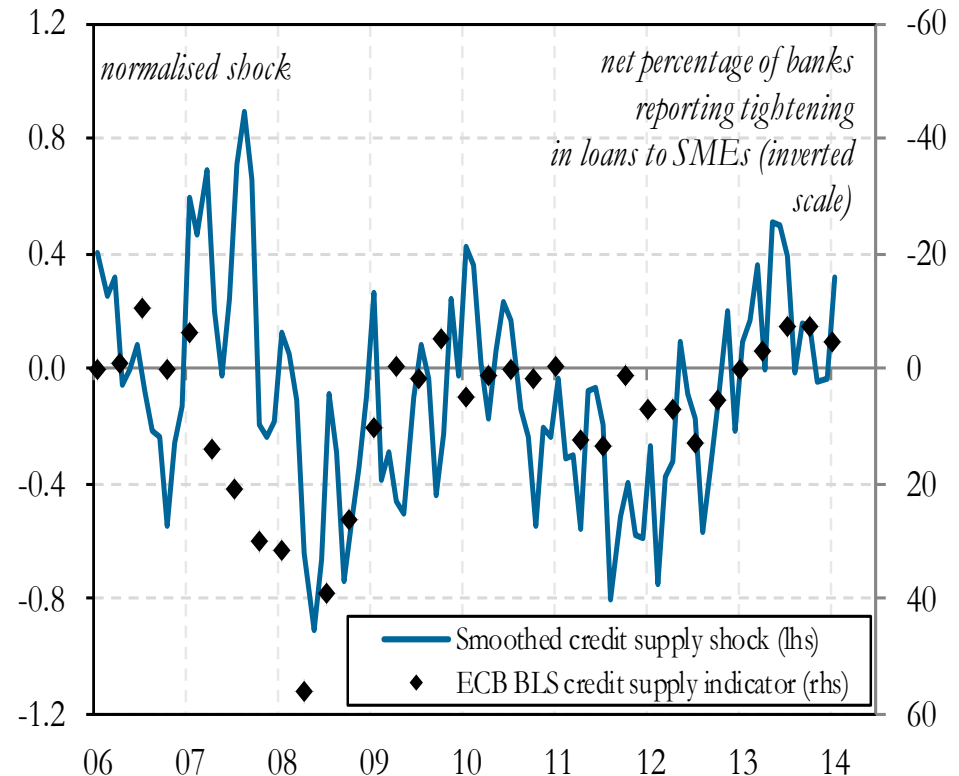
Associated with a tightening of area-wide credit supply conditions ...

Change in credit standards for business loans



Source: ECB

Estimated shocks to bank credit supply for business loans

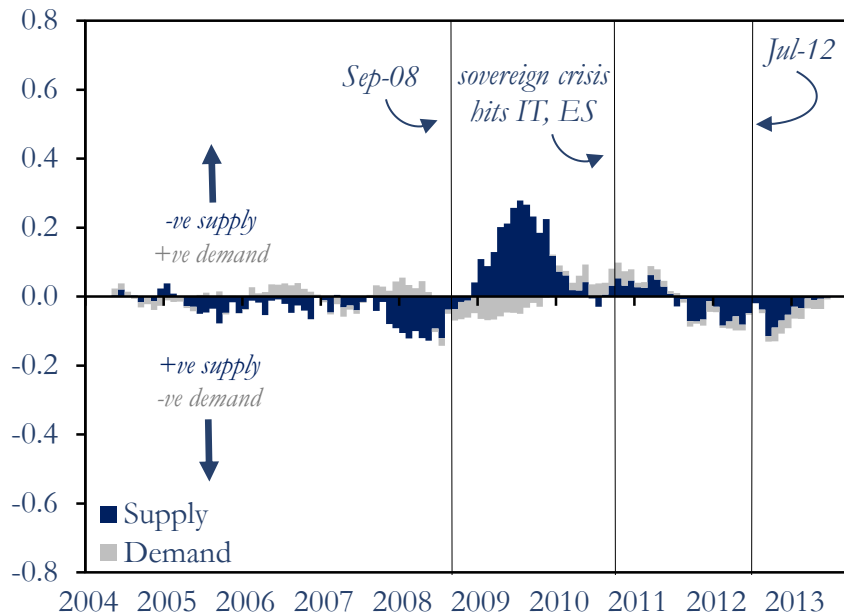


Source: Goldman Sachs Global Investment Research

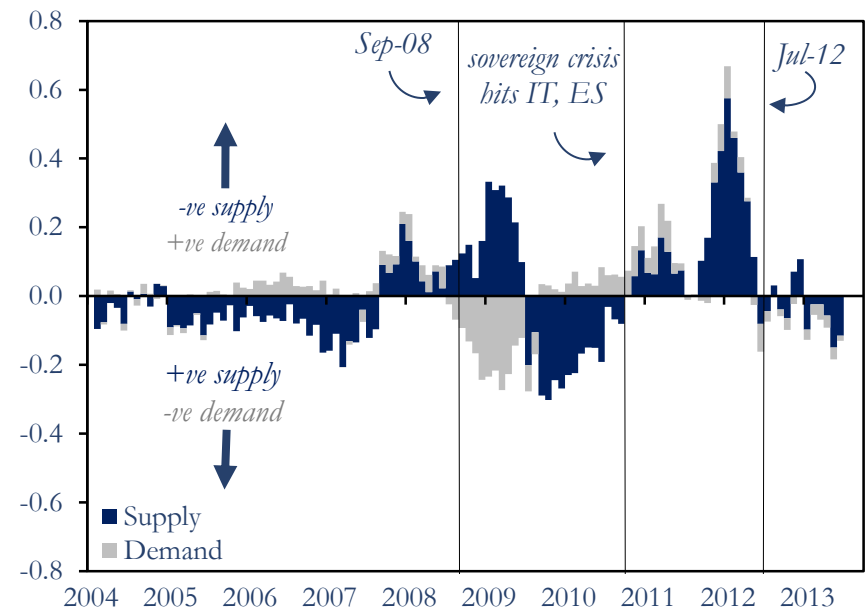
... which was uneven across countries and across time

Impact of shocks to bank lending on bank lending rates ...

in Germany



in Italy



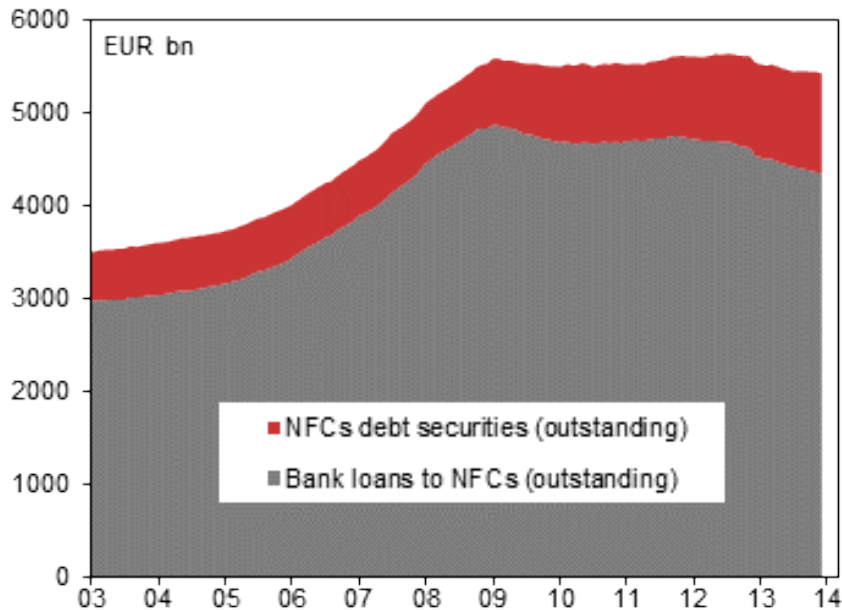
Source: Goldman Sachs Global Investment Research

The Present

Significant corporate debt overhang, high stock of non-performing loans and excessive bank dependence in external financing all weigh on Euro area economic prospects

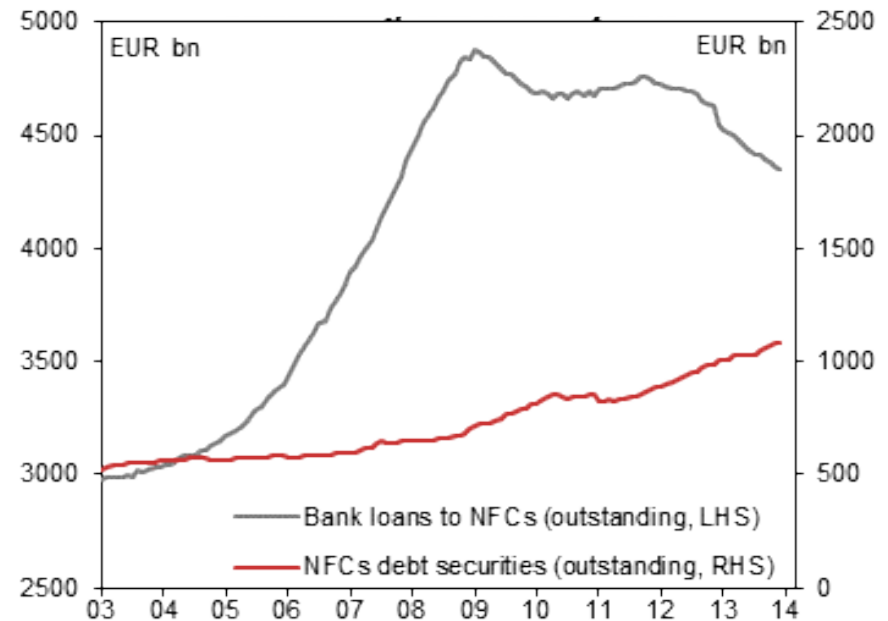
This matters more as corporate borrowing in the Euro area is overwhelmingly from banks

Stock of outstanding corporate debt is overwhelmingly bank loans



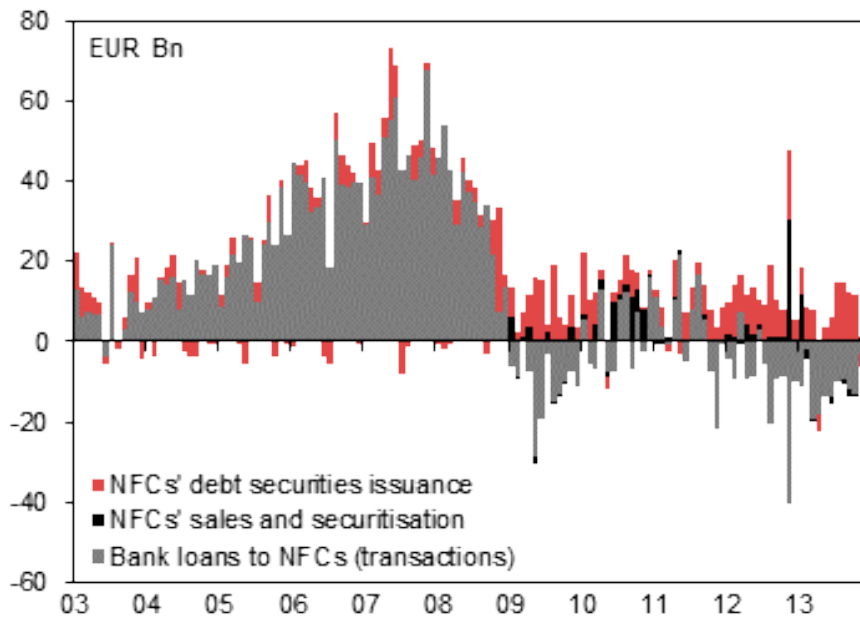
Source: ECB, Goldman Sachs Global Investment Research

Although there was some substitution into corporate securities issuance during the crisis

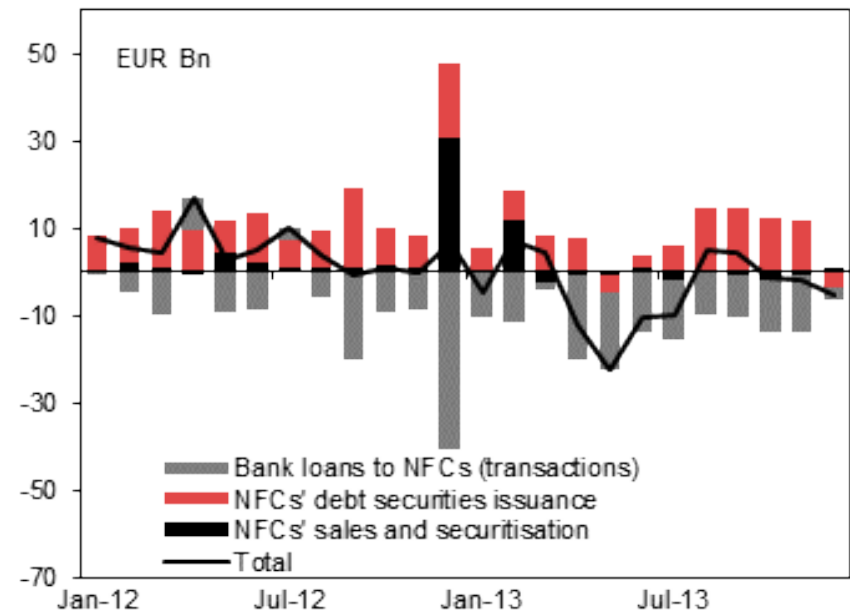


While scope for substitution exists, it is limited by structure of European corporate sector

Flow of bank loans to NFCs turned negative in crisis ...



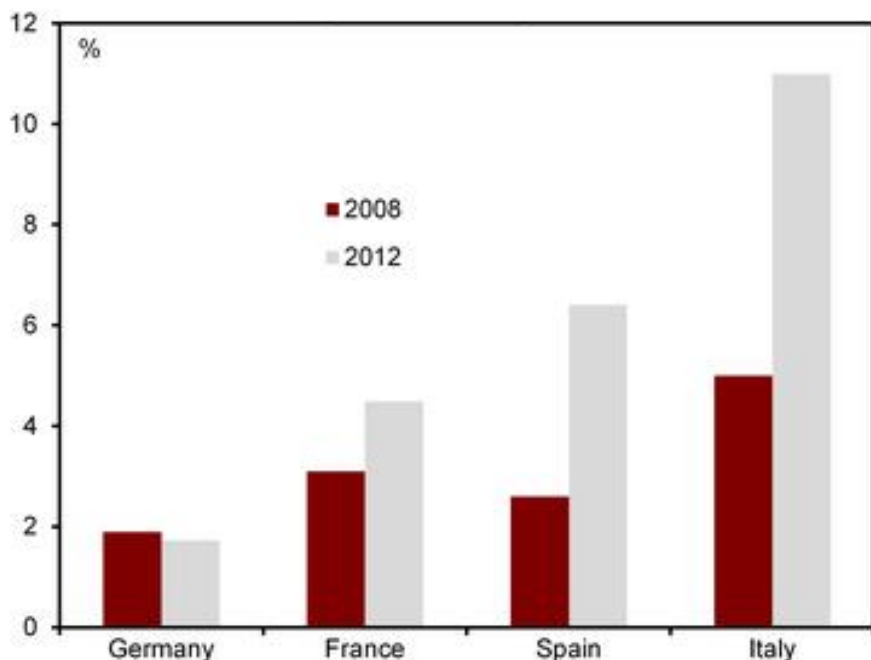
... but there was some substitution into issuance of corporate debt securities



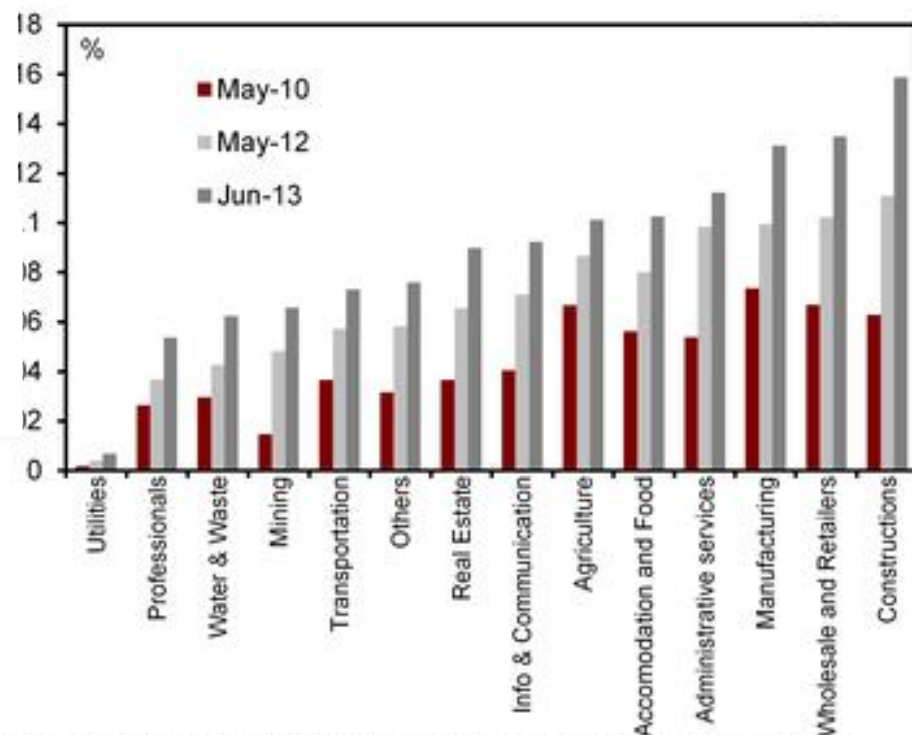
Source: ECB, Goldman Sachs Global Investment Research

Significant rise in non-performing roles, with substantial variation by country and sector

Non-performing loans by country



Italian NPLs by sector



Source: ECB, Banca d'Italia, Goldman Sachs Global Investment Research

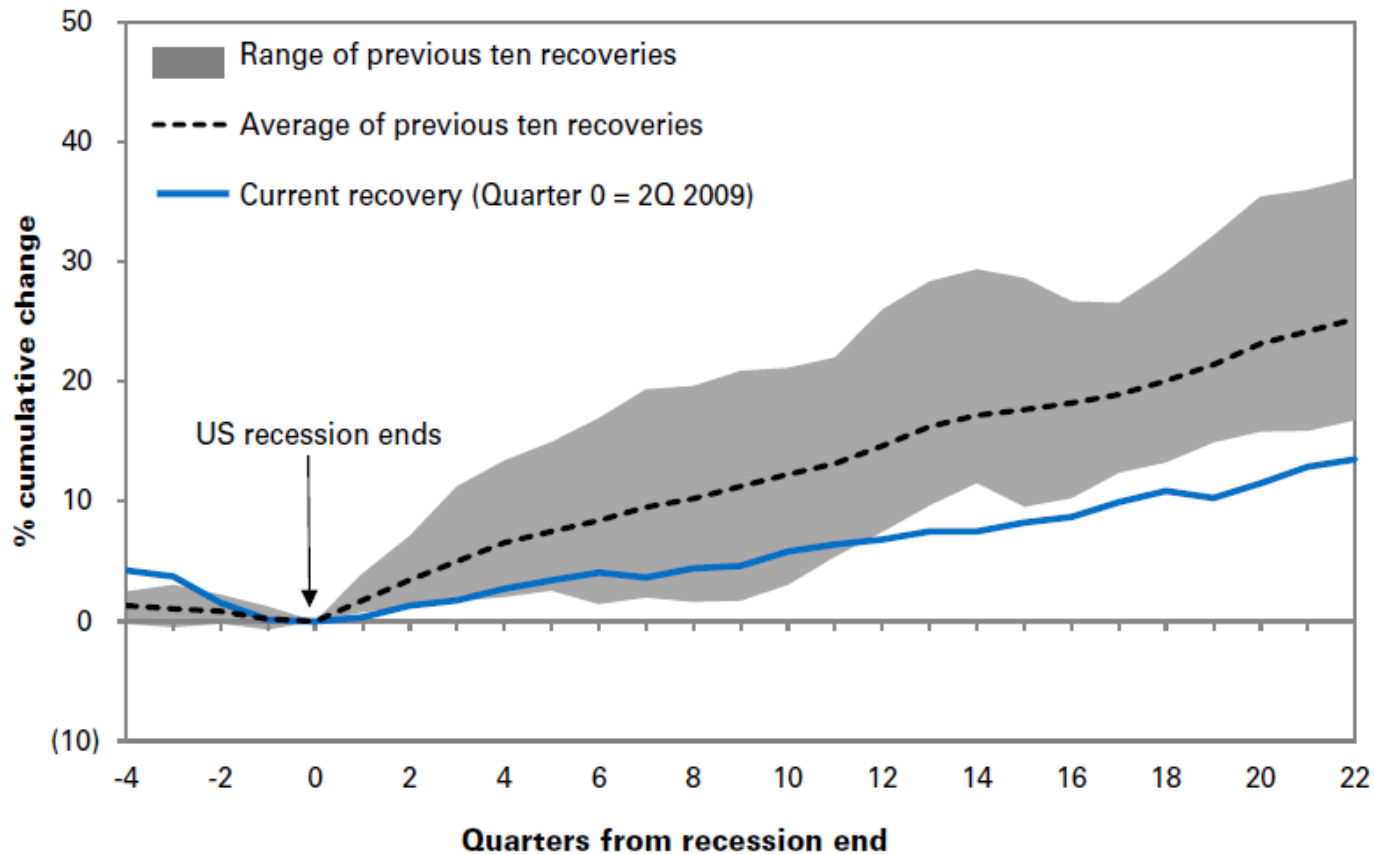
The Future

Deepening corporate securities markets, extending the menu of external financing options for companies and improving bank funding opportunities are all sensible initiatives – but no panacea

A weak US macroeconomic recovery ...

Exhibit 1: The recovery in real GDP lags historical recoveries

Reflects recoveries between 1949 and 2014; growth in real GDP

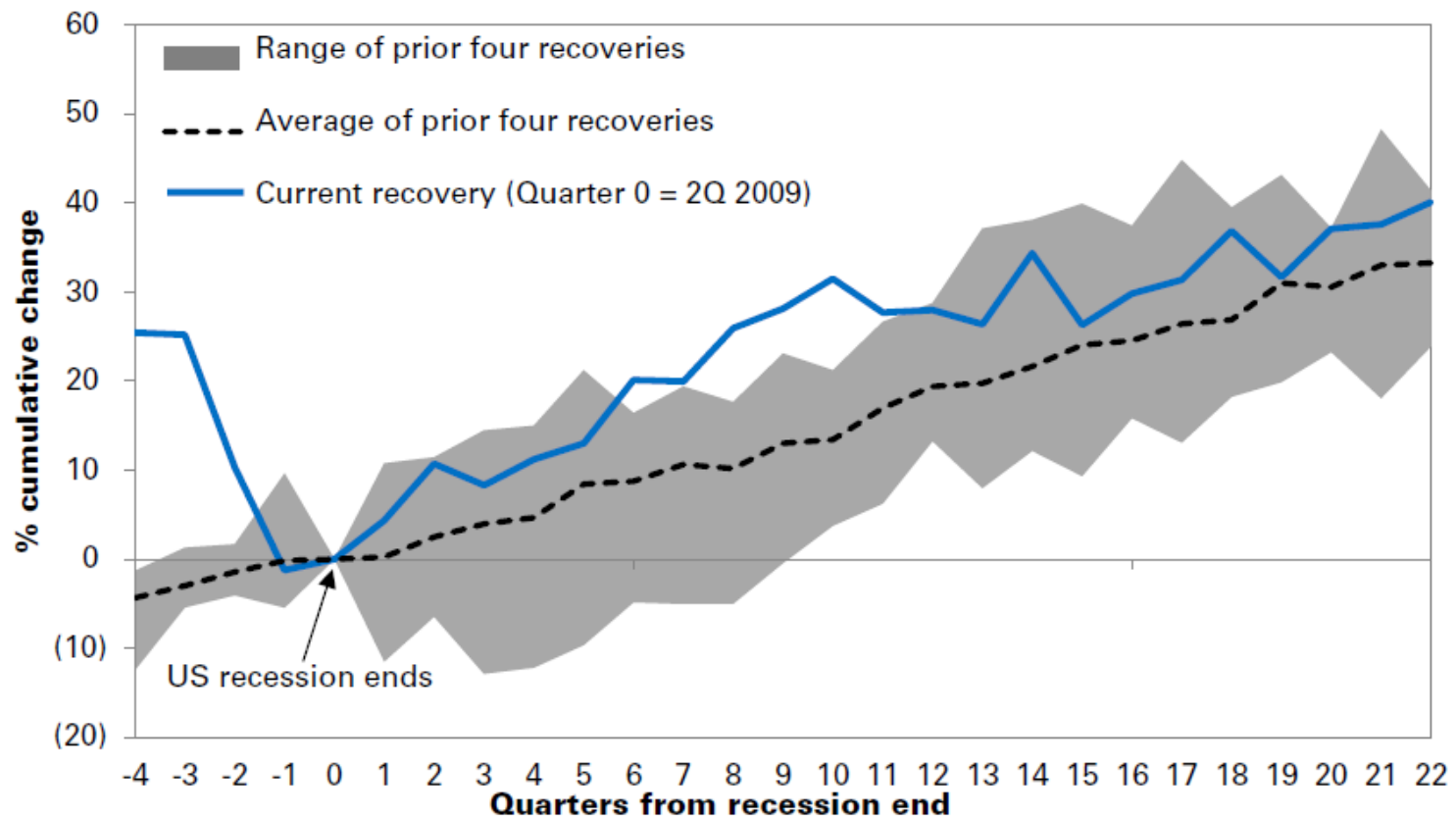


Source: Bureau of Economic Analysis (BEA), Goldman Sachs Global Investment Research.

... although (in terms of revenue) large US firms are (out) performing historically

Exhibit 3: S&P 500 companies (ex-financials) have experienced historically robust revenue growth since the recession ended in 2009

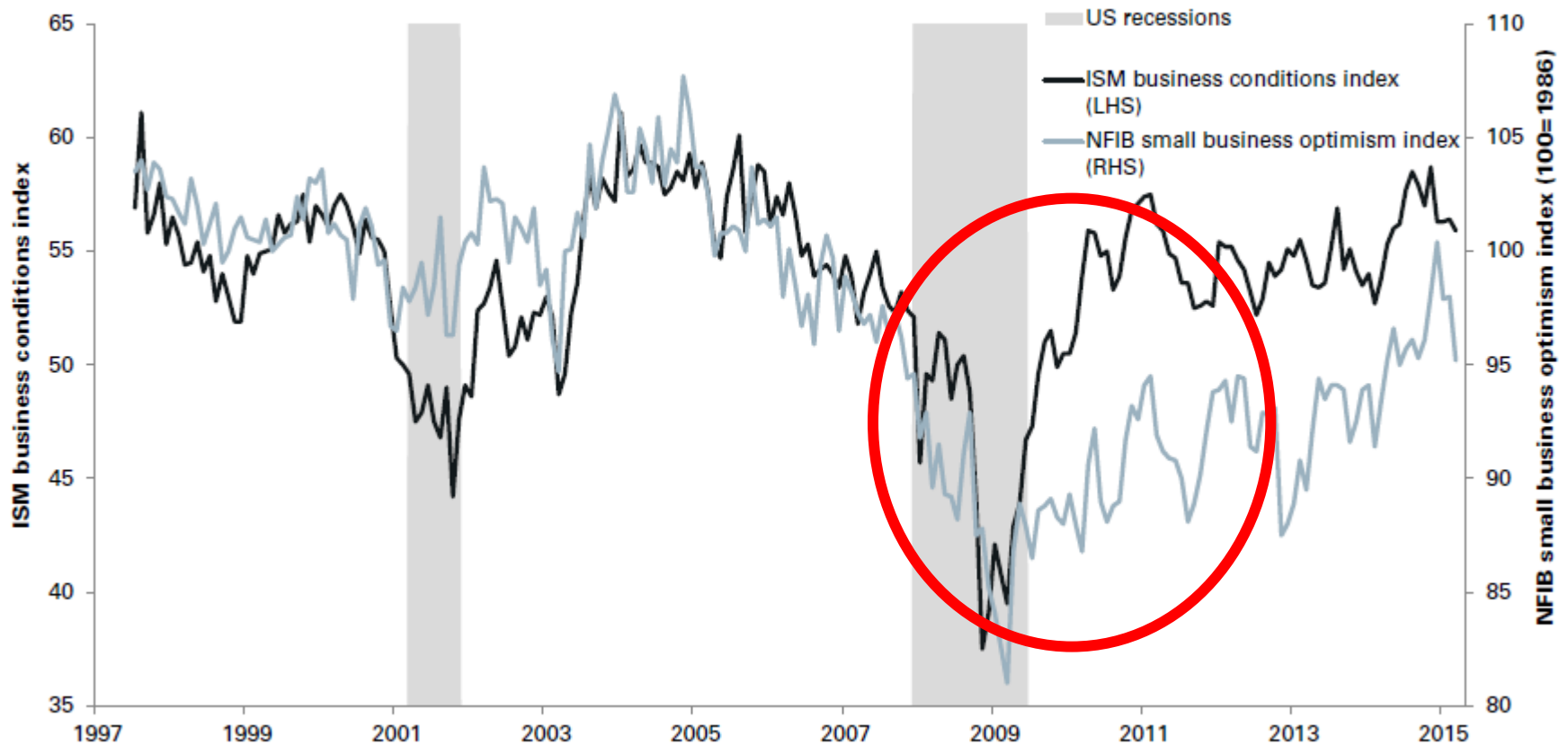
Reflects recoveries since 1980 (latest available data are as of 4Q2014)



Source: Compustat, Goldman Sachs Global Investment Research.

Small US firms (<500 employees in US Federal data) lag behind the large firms

Exhibit 4: NFIB and ISM surveys indicate that small firm growth has only recently shown signs of converging toward large firm growth

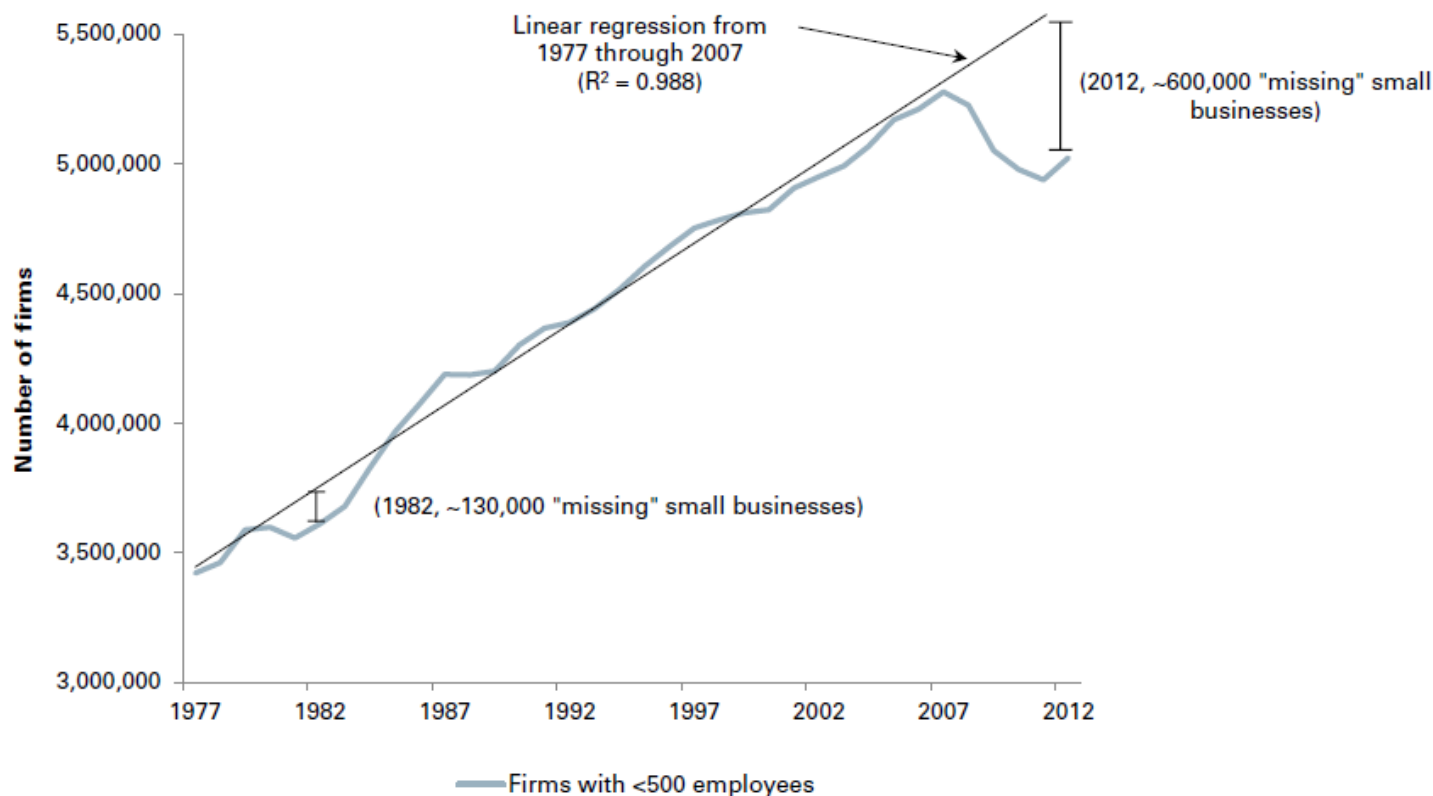


Source: ISM, NFIB, NBER, Goldman Sachs Global Investment Research.

600K 'missing' small firms in the US following the financial crisis

Exhibit 5: The number of small firms declined over the five years from the onset of the crisis

Data available from 1977 to 2012

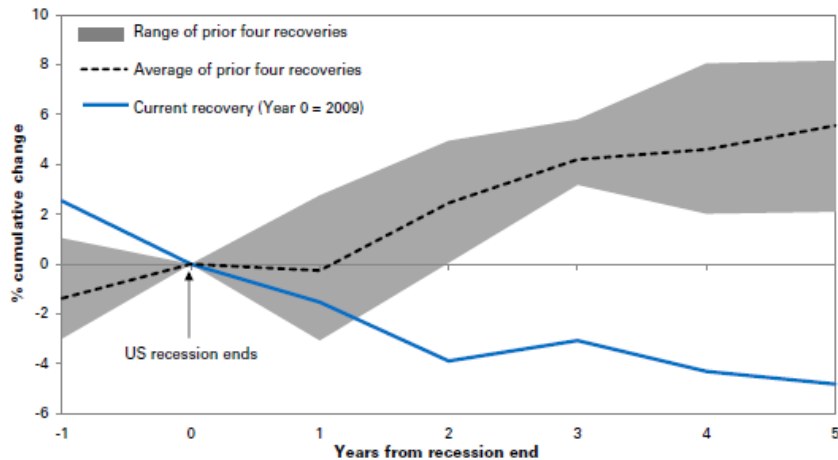


Source: US Census Bureau, Goldman Sachs Global Investment Research.

Fewer US 'start-ups' – *but keep in mind that most start-ups are not Google or Facebook*

Exhibit 8: Growth in unincorporated self-employed workers has been well below the historical post-recession trend

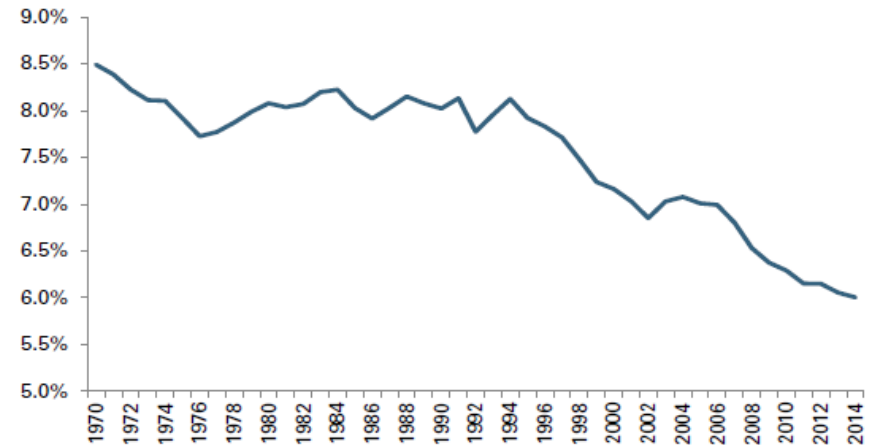
Reflects recoveries between 1980 and 2014



Source: BLS Current Population Survey, Goldman Sachs Global Investment Research.

Exhibit 9: Unincorporated self-employed workers are a shrinking part of the labor force

Self-employed workers as a proportion of the total civilian labor force



Source: BLS Current Population Survey, Goldman Sachs Global Investment Research.

A Dickensian conclusion

- Hard Times
- Bleak House
- Great Expectations



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