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Banks ready for expiry of government liquidity support

- In line with the easing of the coronavirus restrictions and less uncertainty about the economic development, it is relevant to assess the consequences of the expiry of deferred payment deadlines for taxes and tax loans.
- The banks are well equipped to make loans to viable corporations when the deferred payment deadlines and loans fall due.
- The corporations currently make little use of the relief packages. On this basis, it is assessed that the banks will be able to handle any deterioration in the creditworthiness of their customers on expiry of the relief packages.

Kr. 165 billion

is the estimated amount of tax payments deferred by the central government for 2020

Read more

Tax loans

have so far been used only to a limited extent

Read more

The banks

have the capacity to handle both new lending and losses

Read more

Fewer corporations receive compensation
The introduction of extensive restrictions to contain the spread of the coronavirus last spring impacted the revenue of many corporations. The Danish central government quickly launched several large relief packages to buoy the business sector, see box 1 at the end of the analysis.

In line with the easing of the coronavirus restrictions and less uncertainty about the economic development, it is relevant to assess the phasing-out of these relief packages.[1] This analysis looks at the banks' capacity to handle lending growth and any losses on existing loans in connection with the government relief packages for corporations being phased out.

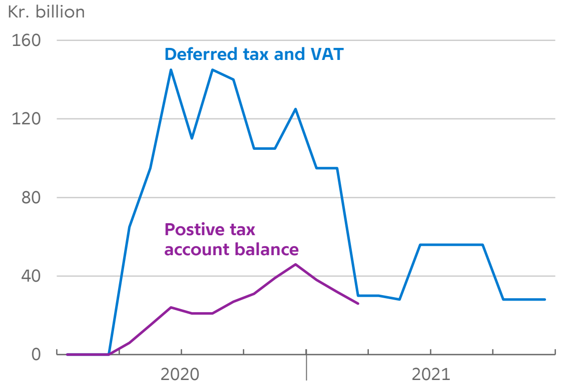
Corporations have been able to apply for partial compensation for expenses such as payroll costs and overheads, while other schemes have provided access to temporary liquidity.

During spring 2020, more than 235,000 employees were furloughed with wage compensation, while about 60,000 self-employed persons have received compensation.[2] Since July 2020, fewer corporations have used the government compensation schemes. Also during the second lockdown in winter 2020-21, the draw on the schemes was at a lower level. The compensation schemes remain open for applications for those corporations that cannot run their business as a result of restrictions.

Deferred payment deadlines have provided great liquidity support for corporations
Deferred deadlines for payment of tax and VAT have significantly increased corporate liquidity. During 2020, payment deadlines were deferred for an estimated amount totalling kr. 165 billion, and the amount is approx. kr. 55 billion in 2021, see chart 1.[3] In comparison, total corporate borrowing from banks amounted to kr. 346 billion at the end of February 2021.

The deferred payment deadlines have released liquid funds for all Danish corporations regardless of whether they were hit hard by the pandemic. Corporations were also given an extraordinary opportunity to pay more into their tax account than the previous threshold of kr. 200,000. At the end of January 2021,

Most deferred tax payments have now fallen due Chart 1



Note: Estimated amount for total volume of deferred payments of withholding tax (A-tax), tax not collected at source (B-tax), labour market contributions and VAT. The actual amount will depend on the level of activity and employment. Positive balance on the Danish Tax Agency's so-called tax account is stated with a deduction of an estimated structural level of kr. 3 billion. The most recent observations for the tax account balance are from the end of March 2021. Deferred payments include schemes adopted no later than on 27 April 2021.
Source: Danish Ministry of Taxation, Danish Tax Agency and own calculations.

1 At the end of March 2021, the parties to the reopening agreement asked a committee of experts to present recommendations for the phasing-out, see Danish Ministry of Industry, Business and Financial Affairs, Danish Ministry of Taxation and Danish Ministry of Finance, *Kommissorium for økonomisk ekspertvurdering af udfasning af hjælpepakkerne II* (Terms of Reference for Economic Expert Assessment of Phasing-out of Relief Packages II), March 2021 (*link, in Danish only*).

2 See Danmarks Nationalbank, Prospects of gradual economic recovery, *Danmarks Nationalbank Analysis (Outlook for the Danish economy)*, No. 12, June 2020 (*link*).

3 In 2020, corporations could also raise interest-free tax loans several times from and including May. Loans totalling kr. 7.4 billion were raised and fall due in November 2021.

nearly 39,000 corporations had a positive balance on their tax account above the previous threshold. This number decreased to about 23,000 corporations at the end of February.

The extraordinary tax account payments reflect corporate liquidity and currently amount to approx. kr. 26 billion. This is about the same amount as the current deferred tax payments of approx. kr. 30 billion.[4]

Limited use of tax loan option

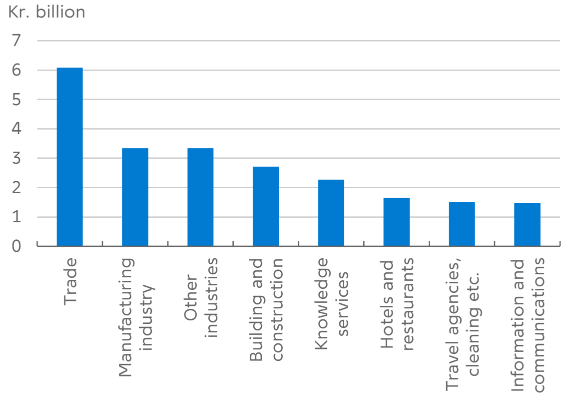
In 2021, the deferred payment deadlines were replaced by the option of raising interest-free tax loans with the central government equal to the due amounts of ordinary tax and VAT payments.[5] The corporations can thus avoid that the previously deferred payments fall due concurrently with the ordinary payments.

By raising a tax loan with the central government, the corporations can borrow the due amount at an interest rate of zero – the same interest rate as for deposits in the tax account. The schemes allow corporations to extend the liquidity support until 2022 and 2023, when the loans fall due. Overall, tax loans of approx. kr. 150 billion can potentially be raised in 2021.

The corporations which have made use of tax loans come from a wide range of industries. Corporations engaged in trade have received the largest share of the tax loans, but also corporations in the manufacturing industry, building and construction as well as knowledge services have received a significant proportion of these loans, see chart 2. The schemes are consequently not just used by corporations in the industries hardest hit by the pandemic and restrictions.

This analysis focuses on non-financial corporations. In 2020, tax loans of kr. 5.7 billion were raised, and loans amounting to a further kr. 16.7 billion have been raised so far in 2021. Added to this are tax loans to sole proprietorships amounting to kr. 1.7 billion in 2020 and a further kr. 2.7 billion in 2021.

Tax loans are used across industries Chart 2



Note: Outstanding amounts for loan schemes for VAT and payroll tax, A-tax and labour market contributions for non-financial corporations (excluding sole proprietorships). The amounts have been calculated on 19 April 2021.
Source: Danish Ministry of Taxation and own calculations.

The corporations had the option of raising tax loans amounting to approx. kr. 35 billion in 2020.[6] Only a limited share of the loan limit was thus used last year.

Tax loans are limited in relation to bank lending

Across the banks, there is some variation in the size of the tax loans in relation to total corporate lending, see chart 3. For half of medium-sized and large banks, government loans constitute between 6 and 11 per cent of their corporate customers' loans. For the other half, government loans constitute less than 3.6 per cent of their corporate lending.

However, the size of the individual government loan is not necessarily an expression of the corporation's liquidity needs. The corporation can only raise a loan equal to the full amount paid in VAT and tax. Some corporations may therefore have raised a larger loan than their liquidity needs warrant. This may

4 The tax account carries an interest rate of zero, and corporations may continuously adjust the maximum amount that they are allowed to have on their account. As the interest rate on corporate deposits with private banks is generally negative, some corporations may have chosen to pay more than their deferred tax payments into their tax account.

5 In the following, VAT and tax loans are referred to collectively as tax loans.

6 See Danish Ministry of Finance, Danish Ministry of Taxation, *Fact Sheet*, April 2020 (*link, in Danish only*).

especially be the case for small and medium-sized enterprises, which settle VAT and tax every quarter or twice a year.

The credit institutions only have limited exposure to corporations that have raised tax loans: Two thirds of corporations that have made use of the government loan schemes have loans with credit institutions. Loans to these corporations constitute 16 per cent of corporate bank loans and 6 per cent of corporate mortgage loans, see chart 4. These loans thus only constitute a limited share of the credit institutions' total corporate lending.

Banks can support viable corporations through the rest of the pandemic

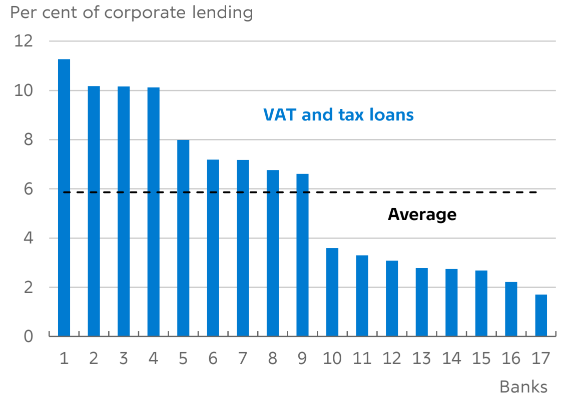
The banks are well equipped to make loans to viable corporations when restrictions are removed and deferred payment deadlines and loans fall due. Also without getting too close to the regulatory requirements for, for example, their capital. Furthermore, the corporations' use of the schemes is currently at a low level. The possible negative consequences of a phasing-out of the schemes will therefore also be limited, and the banks are currently regarded as being able to handle any resulting deterioration in creditworthiness.

The pandemic has hit banks to a lesser extent than was first feared. The banks booked significant impairment charges as a result of the pandemic in the Q1 2020, but actual credit losses were lower than expected for the rest of the year. Furthermore, the banks did not distribute dividends to their shareholders in 2020, and the authorities have eased some of the requirements for the banks. For example, the countercyclical capital buffer was released immediately after the lockdown of the Danish society was announced.

Government relief to the corporate sector also benefited the banks. The banks would have faced greater losses than those incurred in 2020 if the relief packages had not buoyed their customers. All in all, the systemic groups are now as resilient as they were before the pandemic.

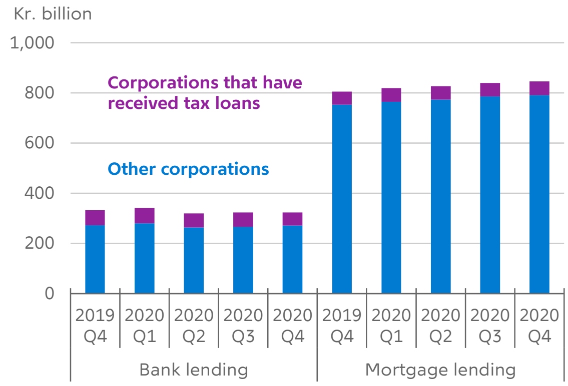
The credit institutions have room to handle any challenges in connection with deferred payment deadlines and tax loans falling due for their corporate customers. The credit institutions have sufficient capacity to handle significant lending growth and concurrently incur further losses on existing loans

Banks' corporate customers have raised tax loans equal to 5.9 per cent of corporate lending Chart 3



Note: Tax loans as a percentage of total lending to Danish non-financial corporations by large and medium-sized banks. Large banks consist of the Danish Financial Supervisory Authority's group 1 and Nordea Danmark, while medium-sized banks consist of the Danish Financial Supervisory Authority's group 2 and Handelsbanken. Lending data as at end of Q4 2020.
Source: The Danish Tax Agency, Danmarks Nationalbank and own calculations.

The corporations that use government loan schemes constitute a small percentage of mortgage credit institutions' books Chart 4



Note: Lending to Danish non-financial corporations by large and medium-sized banks and mortgage credit institutions. Large banks consist of the Danish Financial Supervisory Authority's group 1 and Nordea Danmark, while medium-sized banks consist of the Danish Financial Supervisory Authority's group 2 and Handelsbanken.
Source: The Danish Tax Agency, Danmarks Nationalbank and own calculations.

without failing to comply with their own capital targets or the capital adequacy requirements imposed on them by the authorities, see chart 5. If, for example, the banks were to lose 0.5 per cent of their existing corporate lending, they would still have a lending capacity of around 40 per cent of their existing corporate lending before failing to comply with their own capital targets. In comparison, the systemic credit institutions expensed impairment charges totalling 0.3 per cent of their lending and guarantees to their corporate customers in 2020.

It must be expected that the credit institutions' lending capacity may be limited when they approach their own capital targets, while the authorities will intervene with a number of measures if the credit institutions fail to comply with their capital adequacy requirements.

Some factors which may reduce the systemic credit institutions' capacity have not been included in the calculations on which the chart is based.

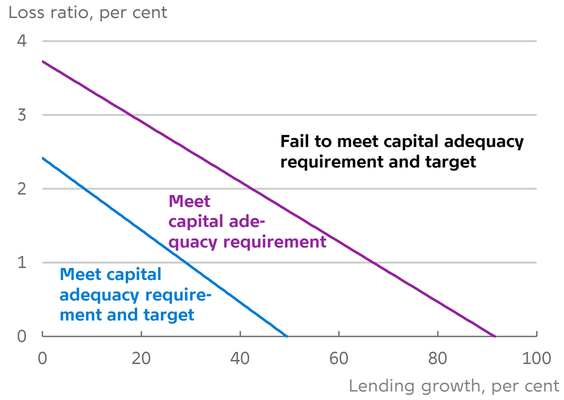
Firstly, it has been assumed that new corporate lending has the same average risk weight as existing corporate lending. If new lending consists increasingly of loans without collateral or loans granted to financially weaker customers, the average risk weight may be higher. In relation to the capital requirements, the credit institutions should also be prepared to handle re-establishment of the countercyclical capital buffer and future reforms of requirements for their capital adequacy.

Secondly, other factors may pull the capacity upwards. The calculations thus disregard the credit institutions' current earnings before impairment charges, which may, over time, be used to handle their impairment charges and losses. Although the systemic credit institutions booked impairment charges due to the pandemic in 2020, they thus all ended the year with positive results. The credit institutions' possibility of expanding their capacity by, for example, issuing more equities or hybrid core capital has also been disregarded.

Corporations already have access to liquid funds with their bank

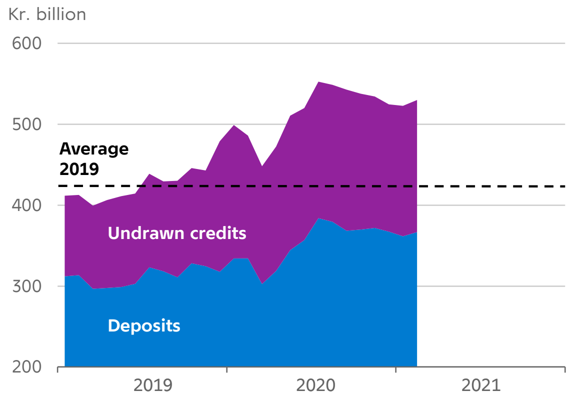
Overall, the corporations increased their bank deposits significantly in 2020, see chart 6. This was not expected at the outbreak of the pandemic. Corporate deposits especially increased in the months in which the tax and VAT payment deadlines were

Systemic credit institutions have capacity for high lending growth or losses on corporate lending Chart 5



Note: Systemic credit institutions. The institutions' exposures comprise both bank loans and mortgage loans. It is assumed that new corporate lending has an average risk weight of 24.7 per cent, which is the same average risk weight as for the credit institutions' current lending as well as other exposures to corporate customers. The assumption is based on the credit institution's total excess capital adequacy in relation to the highest of the requirements for the risk-based minimum capital requirement and overall buffer requirement, as well as the unweighted leverage ratio requirement. The possibility of increasing capital and using current earnings has been disregarded. Data calculated year-end 2020.
Source: The Danish Financial Supervisory Authority and own calculations.

Corporate deposits and undrawn credit facilities remain at a high level Chart 6



Note: Undrawn credit facilities are the undrawn part of confirmed credit and liquidity facilities in Danish kroner to non-financial corporations. The most recent observations are from February 2021.
Source: Danmarks Nationalbank and own calculations.

deferred. The calculation of corporate deposits covers the period up to and including end-February 2021. Corporate deposits are expected to fall to a lower level by end-March, when many corporations pay dividend for 2020 and a number of tax payments fall due.

In addition, some corporations secured access to liquidity with extended credit facilities during 2020. These are facilities under which the banks have undertaken to disburse credit amounts. Many of the facilities still exist, but they have not yet been drawn on. A significant part of the corporate sector thus does not appear to have been challenged in terms of their liquidity during the pandemic.

Many liquidity-challenged corporations were also challenged before the pandemic

The corporations that have made use of the government loan schemes were assessed as having a higher credit risk than other corporations already before the pandemic, see chart 7. The banks' lower credit quality assessment is also reflected in a higher average interest rate on loans to the corporations which have made use of government loans. The central government's credit risk in granting tax loans to corporations is thus assessed to be higher than the average credit in the credit institutions' corporate lending.

During the pandemic, there has been an increase in both the share of lending for which the banks report a significant increase in credit risk (impairment stage 2) and in the share of lending with credit deterioration (impairment stage 3). This development is seen in connection with lending to corporations that have made use of the government loan schemes, whereas this has not been the case for the banks' other lending.

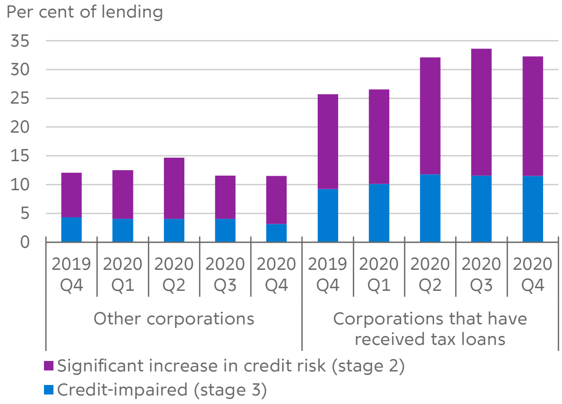
Important that non-viable corporations can still enter into liquidation

Although economic activity decreased significantly in 2020, the total number of liquidations was slightly lower than in previous years, see chart 8. However, the opposite picture emerges in the industries that have been hit hardest during the pandemic. Thus, significantly more hotels went into liquidation last year relative to previous years.

The low level of liquidations in 2020 suggests that government loan schemes have helped keep both viable and already weak corporations afloat. It is a

Poorer credit quality for customers using government loan schemes

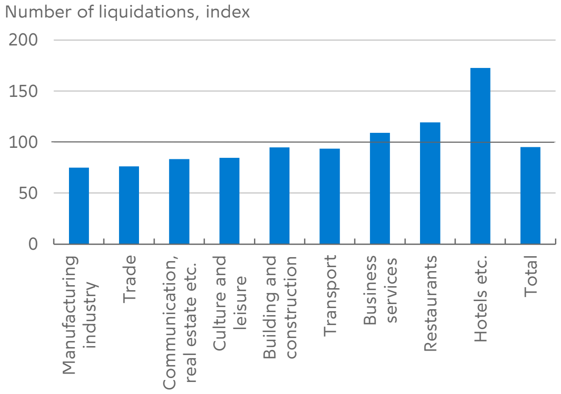
Chart 7



Note: Lending broken down by impairment stages. The remaining lending is in impairment stage 1 without any significant increase in credit risk.
Source: The Danish Tax Agency, Danmarks Nationalbank and own calculations.

Overall, fewer liquidations in 2020, but largest increase in most vulnerable Industries

Chart 8



Note: The index has been calculated based on the average number of liquidations for the period 2015-2019 = 100. Liquidations for active corporations. Data for 2020.
Source: Statistics Denmark and own calculations.

well-known fact that such schemes may hamper the business dynamics that result in growth of competitive corporations and closures of less productive corporations.[7]

7 See Kuchler, Bess and Werner, The COVID-19 crisis reduces Danish growth potential, *Danmarks Nationalbank Economic Memo*, No. 9, June 2020 (*link*).

Government liquidity support measures and compensation schemes

Box 1

Shortly after the outbreak of the pandemic and the first lockdown of the Danish society, the authorities quickly launched a series of temporary guarantee and government relief packages to limit the negative effects for the affected corporations. The relief packages contained both liquidity-supporting and cost-reducing measures.

Liquidity-supporting schemes

Corporate liquidity has especially been supported by deferrals of a number of deadlines for companies to pay A-tax, labour market contributions and VAT as well as the option to raise loans against paid A-tax, labour market contributions, VAT and payroll tax. The Danish Ministry of Taxation thus estimates that payments totalling kr. 165 billion were deferred in 2020.[1] In addition, some corporations had the option of raising tax loans corresponding to the value of due payments of VAT for around kr. 35 billion.

In connection with most deferred payments having fallen due in 2021, corporations have been able to raise tax loans with the central government at zero interest rate of the same amount as the due payment obligations. With a number of tax loan schemes, corporations have an option of raising loans for an overall amount of kr. 170 billion, and these loans do not fall due until in the first half of 2022.

The cap on payments into the corporations' tax account has been temporarily suspended. Previously, a balance of more than kr. 200 was generally transferred to the corporation automatically, while the corporation could increase the threshold to maximum kr. 200,000. During the pandemic, the threshold has been raised to kr. 100 billion. At the same time, the corporations can continuously adjust the threshold on their tax account, allowing them both to deposit more funds and withdraw funds from the account on an ongoing basis. Tax account deposits carry an interest rate of zero, which, in most cases, is higher than the negative interest rate most often charged on bank deposit accounts for corporations.

In continuation of the first lockdown, several government guarantee schemes have also been established to support corporate access to credit in the private banking sector. Under certain conditions, banks have thus been able to make loans to corporations against collateral in a government loss guarantee. The schemes have a number of objective requirements regarding the financial position of corporations, and the schemes can be used only by corporations that have incurred or expect to incur a revenue loss of at least 30 per cent due to the pandemic. However, the credit assessment is to be performed by the individual bank. In this context, the banks bear part of the risk of loss when the schemes are applied and must cover 10-30 per cent of any loss.

Compensation schemes

The cost-covering measures comprise a number of compensation schemes to cover parts of the corporations' payroll costs and overheads, among other expense items. Self-employed persons and freelancers have also been given the opportunity to apply for compensation for loss of earnings. In addition, a number of schemes have been set up to compensate, for example, organisers of major events, artists, cultural institutions and mink farmers.

The schemes have been targeted at the corporations that were or expected to be particularly severely affected by the coronavirus restrictions. To receive pay compensation, at least 30 per cent or more than 50 of the corporation's employees had to be furloughed without working from home. The scheme for overheads required an expected decrease in revenue of at least 35 per cent. The scheme for self-employed persons required an expected loss of revenue or income of at least 30 per cent. Some of the requirements for being eligible to receive compensation have been adjusted in connection with the new restrictions introduced during autumn 2020.

Several compensation schemes have remained active for those corporations that still cannot run their business as a result of restrictions. But the corporations' use of the schemes has fallen to a much lower level than previously seen.

1. Danish Ministry of Taxation, *Fact Sheet*, March 2020 (*link, in Danish only*).

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