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FINANCIAL REVIEW

RBA expects thousands of extra business bankruptcies

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The Reserve Bank of Australia is bracing for thousands of extra small-business failures and a rise in household financial stress over the coming months when loan repayment deferrals and government income supports end.

The looming rise in corporate insolvencies will hurt other business suppliers owed money by failed firms and also cost jobs, the RBA warned.


Reserve Bank governor Philip Lowe, right, and deputy governor Guy Debelle: the bank warns bankruptcies will increase next year. **Alex Ellinghausen**

The RBA's biannual financial stability review said COVID-19-linked government subsidies, up to $260 billion in bank loan repayment deferrals and rent waivers had increased business "cash buffers" since the COVID-19-induced recession struck in March.

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The government supports, particularly temporary insolvency relief, are estimated to have reduced the number of business failures by about 4600 so far and would rescue more than 10,000 firms in total.

The federal government's budget this week shifted away from propping up unviable firms through schemes such as the $102 billion JobKeeper wage subsidy, instead supporting businesses that have a better prospect of surviving the new COVID-19 economy.

Fresh from rapidly legislating $50 billion of tax cuts for workers and business, Prime Minster Scott Morrison said on Friday there was a transition afoot from immediate crisis measures to "cushion the blow", to "recovery" to encourage hiring, business investment and consumer spending.

Emergency measures such as JobKeeper, cash flow payments from the Australian Taxation Office and a temporary freeze on director liability for insolvencies will roll off between January and March.

If the estimated 3 per cent fall in business revenue late in the 2019-20 financial year fails to recover, annual business revenue would plunge a further 9.5 per cent in 2020-21, according to the RBA analysis.

This would cause an extra 5200 firms to fail, on top of the typical 15,000 to 20,000 business closures each year in Australia, both because of insolvency and voluntary exits.

'Zombie businesses'

"However, business failures will rise substantially when loan repayment deferrals and income support come to an end," the RBA said.

"Business failures have flow-on effects to their creditors, both financial institutions and other businesses, and their employees."

During COVID-19, firms in accommodation and food services, arts and recreation and other services industries affected by border closures and social distancing rules have been the most vulnerable.

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Despite the sharp recession, the number of businesses entering administration has fallen to a record low because of the government temporarily waiving director liability for insolvency.

The number of administrators appointed was 77 per cent lower in the week beginning September 30 compared to the corresponding week last year, data from the Australian Securities and Investments Commission shows.

Roger Mendelson, chief executive of Prushka Fast Debt Recovery, warned there were many "zombie businesses" that would fail when they hit the "insolvency cliff" in the new year.

Shake-up in legislation

Treasurer Josh Frydenberg in September unveiled the biggest shake-up to insolvency legislation in 30 years, by enabling struggling firms with debt below $1 million to avoid immediate receivership or voluntary administration.

A small company facing financial distress can seek advice from an insolvency practitioner about developing a restructuring plan.

The operator, working with the adviser, would then have 20 days to develop the plan, which would include restructuring debt and preparing a case for creditors to vote on.

The current temporary director insolvency moratorium would be replaced by the new law at the start of next year.

Before COVID-19 hit, more than half of firms had only enough cash on hand to cover one month of expenses, with small unincorporated firms the most vulnerable compared to large and publicly listed companies which had access to cash, bank credit lines and capital markets, the RBA said.

On the household side, despite the recession and rising unemployment, unprecedented government income handouts had led to an overall rise in household incomes in the first half of the year, the RBA said.

Households' cash flow also benefited from loan repayment deferrals and the early release of $34 billion in superannuation savings.

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While the Australian financial system is in a strong position, risks are elevated.

— RBA statement

Nervous households had greatly increased their savings. "This has included households making larger payments into mortgage offset and redraw accounts," the RBA said.

"However, with unemployment having increased and many employees working reduced hours, the share of households experiencing financial stress has increased and will increase further."

"While some households are struggling, the finances of most households are faring well to date and demand for housing has held up."

"There have been small falls in housing prices in Sydney and Melbourne, with these being larger in inner city areas."

Financial markets expect the RBA to cut the 0.25 per cent cash rate to 0.10 per cent at its meeting next month, and more aggressively buy government debt.

The RBA said some commercial real estate also posed significant risks for lenders and leveraged investors.

"Structural change had been driving rising retail property vacancy rates and falling valuations, and this has accelerated with the pandemic," it said.

"Conditions in office markets had been tight prior to the crisis, but with the economic downturn and changing expectations of future office use, conditions have deteriorated."

Australia's profitable and well capitalised banks were well positioned and most of their loans were well secured by assets, the RBA said.

"While the Australian financial system is in a strong position, risks are elevated.

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"These risks to the financial system would be exacerbated by a weaker-than-expected economic recovery, for example stemming from further setbacks on the health front or international political tensions.

"However, stress tests of the Australian banking system indicate that banks would remain above their minimum capital requirements even if the economic contraction is substantially more severe than expected.

"Given their strong balance sheets, banks will be well placed to continue lending, supporting the economic recovery and so in turn the Australian financial system," the RBA said.