Box 5

INTEGRATED EURO AREA ACCOUNTS FOR THE FIRST QUARTER OF 2010[1]

The integrated euro area accounts offer comprehensive and consistent information on the income, spending, financing and portfolio decisions of the institutional sectors of the euro area. The accounts up to the first quarter of 2010, released on 29 July 2010, show further signs of normalisation, with the household saving rate declining, risk appetite recovering and net worth rising. At the same time, the non-financial corporate sector showed a financial surplus, with the need for external financing limited by increased availability of internal funds. Patterns of disintermediation in favour of market instruments continued across sectors.

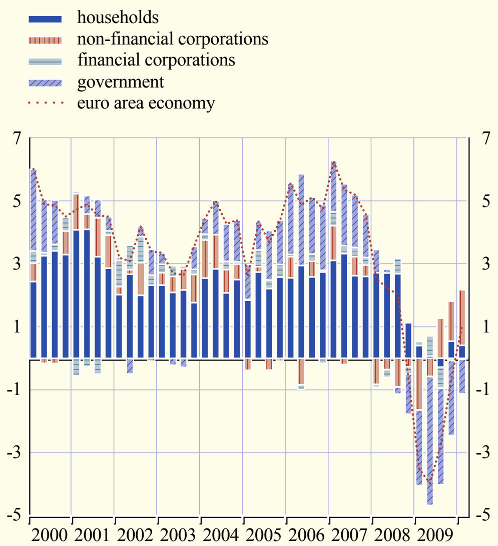
Euro area income and net lending/net borrowing

The pick-up in the growth rate of euro area nominal disposable income that started in the second quarter of 2009 continued in the first quarter of 2010 with a return to a positive yearly growth of 1% (see Chart A), benefiting non-financial corporations (NFCs) on the back of increasing operating surpluses. Moreover, the yearly decline in government disposable income moderated as the economy recovered slightly and fiscal consolidation packages unfolded, in particular through tax increases. By contrast, and in part reflecting the improvement in government income, household nominal income growth slowed.

1 Detailed data can be found on the ECB's website at http://sdw.ecb.europa.eu/browse.do?node=2019181.

Chart A Euro area gross disposable income and sectoral contributions

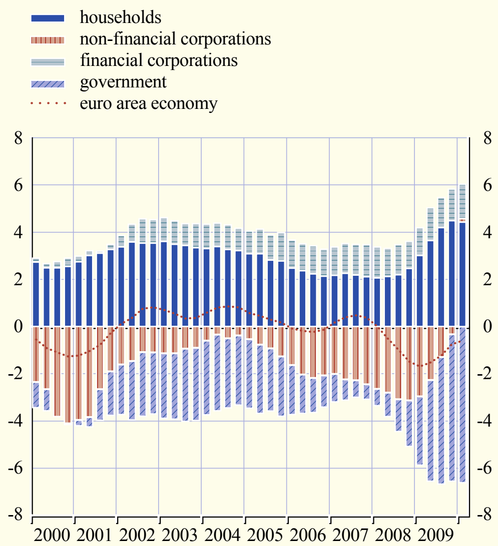
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart B Euro area net lending/net borrowing

(percentages of GDP; four-quarter moving sum)



Sources: Eurostat and ECB.

Against that background, euro area gross saving continued to decline as observed since the end of 2007. However, the pace of the yearly contraction in saving moderated significantly (to an annual rate of change of -1.7%), reflecting the increase in NFCs' operating surpluses and less rapid contractions in government saving. At the same time, the household saving rate fell for the third consecutive quarter to 14.6% (seasonally adjusted).

The annual growth rate of gross fixed capital formation continued to recover, albeit less rapidly than that of savings. These developments contributed to a further improvement in euro area net lending/net borrowing (to a deficit of 0.6% of GDP, on a four-quarter moving sum basis). From a sectoral point of view, this mainly reflects the NFC financial balance, which turned into a surplus, absorbing a slight decline in the household surplus and a further deterioration in the government deficit (see Chart B).

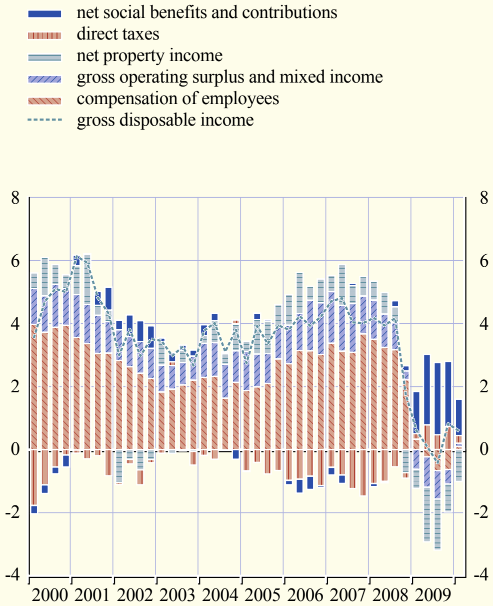
The mirror image of these developments can be seen in the external accounts, showing an improvement in the current account balance and a decrease in external net borrowing (mainly resulting in decreasing net inflows in debt securities). At the same time, the dampening of "gross" cross-border transactions that had characterised external developments since the end of 2008 started to recede, while a shift towards more risky equity instruments can be observed.

Behaviour of institutional sectors

The year-on-year growth of nominal gross disposable income of households dropped to 0.6% (from 0.8% in the last quarter of 2009) on the back of a lower positive contribution from net social benefits and contributions from the government, together with increased taxation following the introduction of the first fiscal consolidation measures, while all other sources of income exhibited subdued growth similar to that seen in the previous quarter (see Chart C). The drop was more acute

Chart C Households' nominal gross disposable income

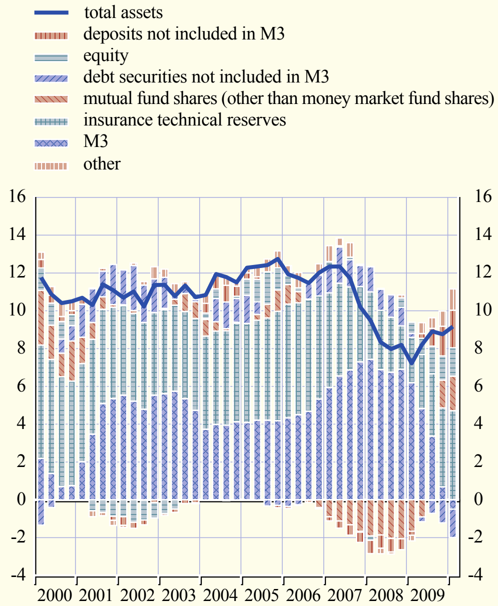
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' financial investment

(four-quarter moving sums; percentages of gross disposable income)



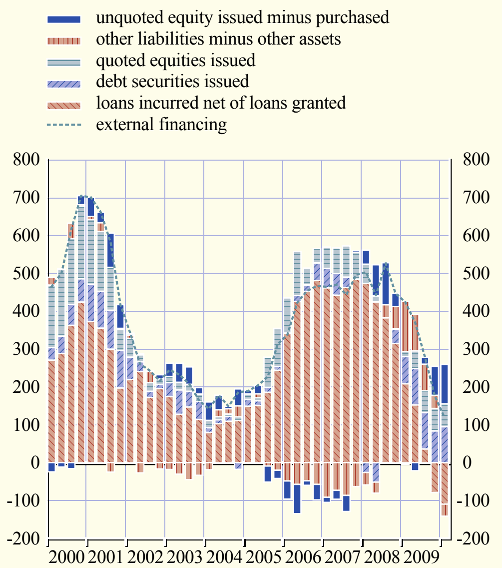
Sources: Eurostat and ECB.

in real terms as a result of the rebound in consumer prices which led the year-on-year growth rate of real gross disposable income to enter negative territory. Household consumption increased robustly to reach year-on-year growth of 1.6% (against -0.1% in the previous quarter), in spite of the lower income growth, indicating some renewed confidence in the context of slightly better labour prospects and an increase in financial wealth driven by equity market developments. This resulted in a further drop in the saving ratio. Household gross capital formation still decreased substantially, albeit somewhat more moderately than in the previous quarter (-7.4% year-on-year, compared with -11.9% previously), reflecting still weak housing markets and deleveraging pressures. This was also reflected in a still subdued uptake of loans (2.1% annual growth rate), although increasing compared with the previous quarter. As financial investment stabilised at an annual growth rate of 3.3%, net lending dropped slightly. At the same time, patterns of portfolio allocation continued to point to liquidity preference receding further, to a renewed search for yield, and to a return of risk appetite. In particular, purchases of equity, non-money market mutual funds and insurance liabilities expanded to the detriment of low-yielding deposits (see Chart D).

The gross operating surplus of non-financial corporations rebounded strongly in the first quarter owing to vigorous exports of goods and continued cost savings, exhibiting a record annual growth of 4.1% (from -3.5% in the previous quarter) which led to a sharp increase in savings as distributed dividends remained subdued (see Chart E). At the same time, the annual contraction in NFC fixed capital formation moderated further, and, as the pace of inventory reductions decreased abruptly, the yearly decline in capital formation slowed markedly, from -21% in the last quarter of 2009 to -2.6% in the first quarter of 2010. However, with saving higher than capital investment, the usual net borrowing position of NFCs turned into net lending on a four-quarter moving sum basis

Chart E NFCs' external financing by source of funds

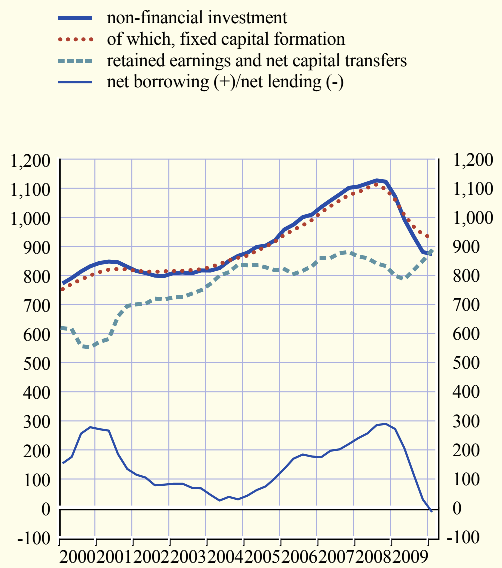
(four-quarter moving sums; EUR billions)



Sources: Eurostat and ECB.
Note: For presentational purposes, some transactions in assets are netted here from financing, as they are predominantly internal to the sector (loans granted by NFCs, unquoted shares and other accounts receivable/payable).

Chart F NFCs' saving, capital investment and net borrowing

(four-quarter moving sums; EUR billions)



Sources: Eurostat and ECB.

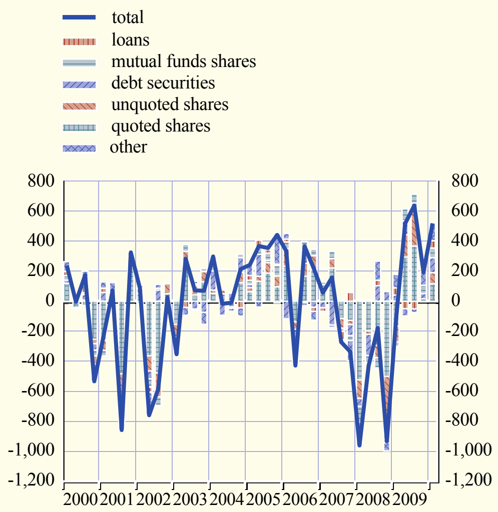
(see Chart F). The resulting build-up of ample liquidity buffers could signal precautionary behaviour, in view of a still uncertain outlook for activity and bank financing, and of ongoing reductions of balance-sheet vulnerabilities. Corporate leverage ratios still remained at historically high levels – the debt-to-gross value added stabilised at 165% while the debt-to-equity (notional stock) ratio stabilised at 70%. In this context, the annual growth rate of financing by NFCs rebounded slightly to 1.1%, from 0.8% in the previous quarter, as the need for external financing was limited by the subdued real investment activities and the ongoing rise in available internal funds which typically precedes any recourse to external funds (the "pecking order" of corporate finance). Pronounced substitution effects are still observed, as market financing (debt securities and quoted shares) more than offset net redemptions of MFI loans.

In the first quarter of 2010 the euro area general government budget balance (net borrowing) deteriorated further to 6.6% of GDP (four-quarter moving sum), compared with 6.2% in the last quarter of 2009. This deterioration, for the ninth consecutive quarter since the end of 2007, mainly reflected broadly stable gross government investment (at 2.7% of GDP) and a further contraction in gross savings (net of capital transfers), which stood at -3.9% of GDP, down from -3.4% recorded in the previous quarter. Gross savings nevertheless showed a diminishing rate of decline – which points to a potential trough in the next quarter – on the back of the operation of automatic stabilisers in a moderately recovering economy, while the impact of most fiscal stimulus measures taken by euro area governments also declined. At the same time, this development was underpinned by tax increases in the context of the introduction of fiscal consolidation measures. The annual growth rate of government financial investment contracted rapidly to -0.7%, by far the lowest value since the beginning of the crisis (a peak of 15.8% was recorded in the second quarter of 2009), as governments scaled down their interventions aimed at stabilising the financial sector. In addition, the cash build-up recorded in previous quarters started to be reduced. As a consequence, financing by issuance of loans and debt securities also slowed to 7.8%, down from 9.5% in the last quarter of 2009. The still high government debt securities issuance continued to be absorbed by MFIs and non-residents, as well as, increasingly, by resident institutional investors.

Gross entrepreneurial income of financial corporations returned to modest positive growth owing to an improvement in net interest received (partly related to carry-trade on government bonds and the steep yield curve). The contribution from the net operating surplus to income growth diminished (to 2.8% from 7.3% in the last quarter of 2009) owing to a moderation in bank spreads and weakness in traditional lending business. In addition, financial corporations have benefited from substantial holding gains in recent quarters (see Chart G) which reached an all-time high in terms of accumulated four-quarter flows of around €1,900 billion in a context of diminishing long-term interest rates and the stock market recovery from the trough recorded in the first quarter of 2009. The annual growth rate of financial investment (netting out interbank deposits) increased to 2.7% from 2.2% in the last quarter of 2009. MFI deposits with non-residents were the main contributors to that development (although still showing a negative four-quarter moving sum), while the growth rate of acquisitions of debt securities by MFIs continued to decline. At the same time, holdings of debt securities by institutional investors (mostly of public debt) continued to rise, in particular holdings by insurance corporations and pension funds (ICPFs), whose acquisitions over the quarter reached a record volume of €77 billion (compared with acquisitions by MFIs of €75 billion). The ratio of equity to financial assets stabilised at 8.8% as the expansion in the balance sheet of the sector was compensated by increases in its equity value.

Chart G Holding gains and losses on financial corporations' assets

(quarterly flows; EUR billions)



Sources: Eurostat and ECB.
Note: This chart provides other economic flows, which mainly refer to holding gains and losses (realised or unrealised) on assets that are valued at market value in the integrated euro area accounts (quoted, unquoted and mutual fund shares and debt securities). For the rest of the asset classes (notably loans), which are valued at nominal value, it shows the changes in balance sheets owing to exchange rate variations and the writing-off of bad assets from the balance sheet of the creditor and the debtor upon recognition by the former that the cash flows associated with the asset can no longer be collected.

Financial markets

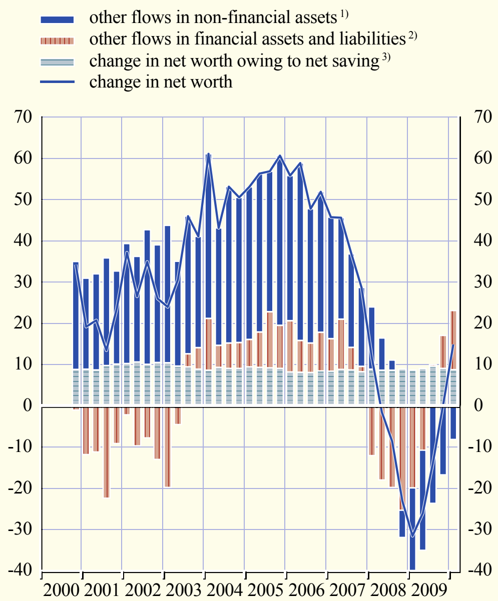
The considerable expansion of net transactions in debt securities that characterised developments one year ago further moderated, although strong NFC issuance continued to substitute for bank loans as has been the case since the end of 2008. The net buyer position of other financial intermediaries (OFIs) reflects large purchases by investment funds, while issuance by special-purpose vehicles (notably in the context of retained securitisations) slowed. In the same vein, ICPFs stepped up purchases, while households were large sellers. Issuance by MFIs continued to be limited and MFIs added moderately to their holdings of debt securities. The rest of the world remained a substantial net buyer, although on a smaller scale than in the previous quarter, reflecting the improvement in euro area net lending. At the same time, issues of quoted shares by NFCs remained robust in the context of an overall disintermediation trend away from bank financing. NFCs were net sellers of equity, and investment funds were prominent buyers. On the mutual funds market, issuance of non-money market mutual fund shares continued the strong acceleration shown in previous quarters on the back of household appetite for riskier and longer-term assets in place of monetary assets. On the loan market, the ongoing reduction in MFI loans to NFCs was accompanied by a moderate increase in loans to households.

Balance sheet dynamics

In the first quarter of 2010 the annual change in households' net worth continued to be positive (after two years of decline), on the back of a stock market rally (see Chart H). The increase in market prices also boosted the balance sheets of banks, which have sizeable positions in equity and debt securities (see Chart G).

Chart H Change in net worth of households

(four-quarter moving sums; percentages of gross disposable income)



Sources: Eurostat and ECB.
Note: The data on non-financial assets are ECB estimates.
1) Mainly holding gains and losses on real estate and land.
2) Mainly holding gains and losses on shares and other equity.
3) This item comprises net saving, net capital transfers received, and the discrepancy between the non-financial and the financial accounts.