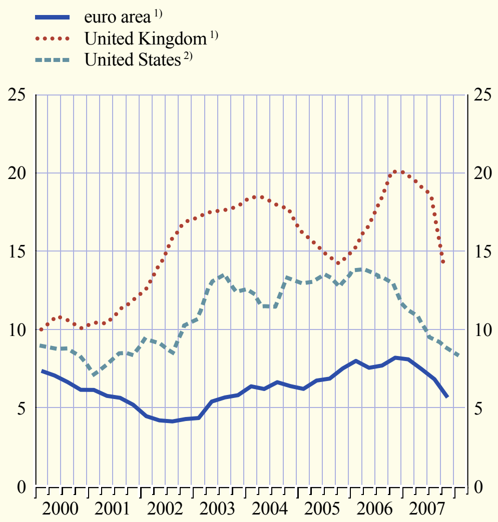
Box 1

A COMPARISON OF MFI LOANS AS A SOURCE OF HOUSEHOLD FINANCING IN THE EURO AREA, THE UNITED KINGDOM AND THE UNITED STATES

Since the onset of the tensions in the financial markets in August 2007, the evolution of MFI lending has come under increased scrutiny. Evaluating whether the banking system can provide sufficient financing to households and non-financial corporations has been essential for assessing macroeconomic prospects. In this context, cross-country comparisons of MFI lending developments give a broader perspective to the analysis. However, a comparison of MFI lending across economies, especially when assessing the implications of such developments for the real economy, has to take into consideration the differences in the structures of financial systems, particularly in terms of the importance of the banking sector relative to other sources of external financing. Against this background, this box compares the importance of MFI loans as part of total household financing in the euro area, the United Kingdom and the United States. The analysis takes into account the differences in the accounting and statistical reporting frameworks that affect the relevant data for each economy.

Chart A Household financing flows

(as a percentage of household disposable income)



Sources: ECB, Eurostat, Office for National Statistics and Board of Governors of the Federal Reserve System.
1) Ratio of four-quarter-cumulated financing flows to households to households' four-quarter-cumulated gross disposable income.
2) Ratio of four-quarter-cumulated financing flows to households to households' four-quarter-cumulated disposable personal income.

To put the relative importance of MFI lending in overall household financing into perspective, Chart A shows the ratio of total household financing flows to household disposable income for the three economies.[1] There are significant differences in the volume of financing that households receive relative to their income, with the United Kingdom being the economy where this ratio is the highest.

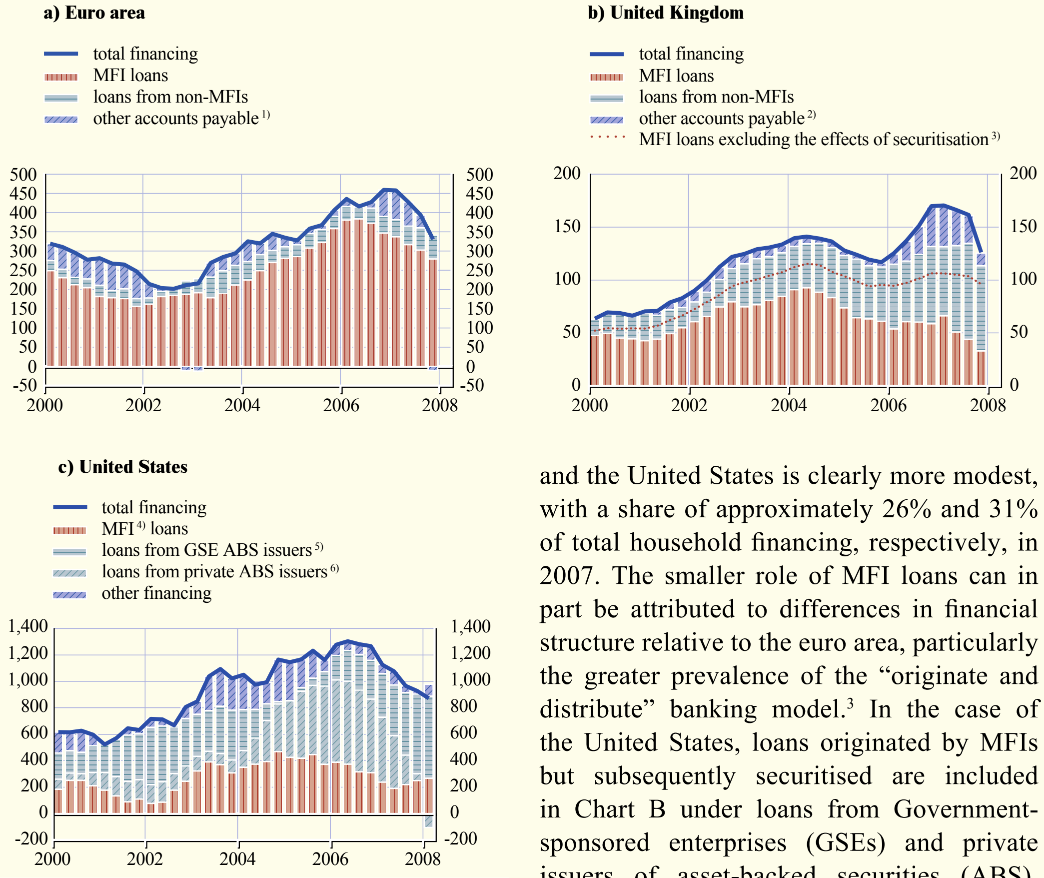
Chart B illustrates the extent to which the importance of MFIs in the total financing of households seemingly varies across the three economies. In the euro area, the MFI sector plays a dominant role in the financing of households, accounting for approximately 85% of the total funds disbursed to them in 2007. The direct role of MFIs[2] in the United Kingdom

1 The delimitation of the household sector in the United States is narrower than in the euro area and the United Kingdom, since the global statistical standard for the compilation of national accounts has not been fully implemented in that country. In particular, sole proprietorships and partnerships are excluded from the household sector and classified as part of the business sector (see the box entitled "Comparability of the national account data of the United States and the euro area" in the February 2004 issue of the Monthly Bulletin).

2 In the United States, the MFI sector is not defined in the official statistics. In order to ensure comparability with the euro area and the United Kingdom, the MFI sector in the United States was approximated by using commercial banks, savings institutions and credit unions.

Chart B Financing of households

(four-quarter-cumulated transactions in billions of local currency units)



Sources: a) ECB, b) Office for National Statistics and Bank of England and c) Board of Governors of the Federal Reserve System and ECB calculations.
1) Also includes net liabilities of financial derivatives, as well as life insurance and pension fund reserves.
2) Also includes debt securities issued by non-profit institutions serving households.
3) Seasonally adjusted.
4) Commercial banks, savings institutions and credit unions.
5) Loans from Government-sponsored enterprises (GSEs) and from agency and GSE-backed mortgage pools.
6) Loans from private asset-backed security issuers.

and the United States is clearly more modest, with a share of approximately 26% and 31% of total household financing, respectively, in 2007. The smaller role of MFI loans can in part be attributed to differences in financial structure relative to the euro area, particularly the greater prevalence of the "originate and distribute" banking model.[3] In the case of the United States, loans originated by MFIs but subsequently securitised are included in Chart B under loans from Government-sponsored enterprises (GSEs) and private issuers of asset-backed securities (ABS). In the euro area and the United Kingdom, securitised loans are included in the category "loans from non-MFIs". In the United States and the United Kingdom, these categories appear to account for a considerably larger share of household financing than in the euro area. However, the prima-facie varying importance of MFI loans reflects not only differences in the financial systems but, importantly, also in the accounting treatment of securitised loans, which impacts on how these items are recorded on MFIs' balance sheets.[4]

The crucial aspect in the respective accounting frameworks relates to whether the MFI that originally granted the loans is allowed to remove them from its balance sheet ("derecognise" them) when selling them in the course of a securitisation transaction, in which case the bank lending

3 For a discussion of loan origination and securitisation, see the article entitled "Securitisation in the euro area" in the February 2008 issue of the Monthly Bulletin.

4 See also the box entitled "The importance of accounting standards for interpreting MFI loan statistics" in the March 2008 issue of the Monthly Bulletin.

statistics will be affected.[5] In the euro area, the application of International Financial Reporting Standards (specifically International Accounting Standard 39, "Financial instrument recognition and measurement") and of certain supervisory policies in some EU Member States, where the "originate and distribute" banking model has become increasingly popular in recent years, has largely prevented credit institutions from removing loans from their balance sheets after a sale to a special purpose vehicle. By contrast, UK and US accounting rules are considerably more favourable towards the derecognition of MFI loans. In the respective statistical reporting frameworks, this has led to a much higher level of outright loan removal in these two economies than in the euro area, even in cases of securitisation operations of a very similar nature and size. As a result, a large share of securitised loans in the euro area are still reported as MFI loans, whereas in the case of the United Kingdom and the United States the volume of loans securitised reduces the MFI loans disbursed and is reported as "loans from non-MFIs" and loans from (private or GSE) ABS issuers respectively.

These considerations show that the role of MFIs in the financing of the household sector is much larger if one focuses on the loan origination process rather than on bank balance sheet statistics. From this perspective, the relative importance of MFIs in providing funds to households is broadly similar in the euro area and the United Kingdom, and to a lesser extent in the United States. In the case of the United Kingdom, this outcome is visible in the development of the series "MFI loans excluding the effects of securitisation", which captures both the loans retained by the MFIs and the loans originated and subsequently securitised. On average, over the period 2000-07, this category accounted for more than 75% of total household financing in the United Kingdom. In the euro area, the sum of MFI loans and loans from non-MFIs,[6] which for this economy can serve as a proxy for loans originated by MFIs, accounted for approximately 90% of total household financing over the same period. In the case of the United States, the volume of loans originated by MFIs was also considerably larger than what is captured by the "MFI loans" series. However, a calculation similar to that made for the euro area for deriving the importance of loans originated by MFIs is not directly possible in the United States, since at least some of the loans held by ABS issuers were originated by entities that would be considered part of the non-MFI sector in the euro area.

When analysing the development of household financing over time, the data for the United States illustrate the increasing role of private ABS issuers in the financing of households from 2004 onwards. Such activity partly replaced funding previously provided by GSEs (such as the Federal National Mortgage Association – Fannie Mae – and the Federal Home Loan Mortgage Corporation – Freddie Mac) and also contributed to the increase in total household financing. However, since mid-2006 the GSEs have again gained in importance, and in the second half of 2007 these institutions became the dominant source of funding for households as financing from private ABS issuers gradually dried up. In the same period, the provision of MFI loans increased in the United States since the offloading of loans through securitisation virtually ceased.

While the overall financing dynamics have been quite similar in all three currency areas since mid-2006, the sharp decline in loans held by private non-bank institutions in the United States has not been observed in the euro area or the United Kingdom. Indeed, in the latter two economies,

5 Loan sales that imply a full transfer of risks and rewards to a separate entity (e.g. an institutional investor) would imply a complete removal of the loan from the seller's balance sheet. This relates to the case of a "true sale" securitisation. Alternatively, the originator may decide to merely sell (part of) the risks attached to the loans it has provided by conducting a "synthetic" securitisation. In this case, the underlying loans continue to be reported on the originator's balance sheet.

6 Loans from non-MFIs consist mostly of loans granted by OFIs, but also by insurance corporations and pension funds, and to a much lesser extent of loans granted by other resident sectors and non-residents.

the volume of "loans by non-banks" was relatively stable until the end of 2007, while the volume of loans provided and retained by MFIs declined. In the euro area, in particular, this ongoing securitisation activity hides, however, a change in the character of the process as in late 2007, and particularly in early 2008, MFIs mainly purchased the asset-backed securities themselves rather than the securities being sold on to the market.

This box has shown that a meaningful comparison of household financing across the euro area, the United Kingdom and the United States has to take into account the differences in the respective accounting and statistical frameworks. Moreover, it should be based on a broad view of household financing and accommodate the structural differences in the respective financial systems. This analysis has shown that the overall dynamics in household financing in 2006 and throughout 2007 were actually quite similar across the three currency areas. However, this apparent similarity still masks considerable differences in the importance of and developments in the underlying fundamentals that drive household financing, such as the strength of economic activity, interest rate dynamics, the evolution of house prices and the level of total household indebtedness. The analysis also suggests that, owing to the differences in the accounting treatment of securitisation, the loans reported on MFI balance sheets may not always be indicative of the risk exposure that banks are facing in these economies. Indeed, the tensions in the financial markets have demonstrated that even within the "originate and distribute" model of banking, considerable risks remain – implicitly or explicitly – with MFIs.