

Box 4

INTEGRATED EURO AREA ACCOUNTS FOR THE SECOND QUARTER OF 2010¹

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 data release of 28 October 2010, covering data up to the second quarter of 2010, includes for the first time the non-financial assets of the private sector. These data show further signs of normalisation in the euro area. Households further reduced their savings ratio (partly reversing the sharp increase observed since the start of the financial crisis) while income growth was again driven by labour and capital income (rather than by government redistribution). Non-financial corporations (NFCs) returned to a net borrowing position on a quarterly basis owing to increasing capital formation. By contrast, nominal flows remained broadly subdued (households' income decreased in real terms) and corporations continued to build up capital buffers via increased retained earnings. Patterns of disintermediation in favour of direct financing through market instruments continued across sectors, albeit somewhat moderated as risk appetite was damped in the context of the sovereign debt tensions.

Euro area income and net lending/net borrowing

The annual growth rate of euro area nominal disposable income rose further in the second quarter of 2010 to 3.7%, after 1.3% in the previous quarter (Chart A), as value added increased robustly. This increase was broadly based across sectors. Retained earnings of NFCs continued to grow in a context of a build-up of capital and liquidity buffers. The annual change in government income turned positive after seven successive quarters of reductions. Household income growth accelerated via an increase in compensation of employees. However, it still remained subdued and continued to contract in real terms owing to more dynamic consumer prices.

For the first time since 2007, the expansion in income translated into an increase in euro area gross saving. This was reflected in the continued high retained earnings of corporations as well as in a deceleration of the decline in government savings. By contrast, and in spite of the increase in household income, household savings fell again as consumption continued to grow also in real terms, albeit at a slower pace than in the previous quarter. The household savings ratio (seasonally adjusted) fell for the fifth consecutive quarter to 14.3%.

Chart A Euro area gross disposable income and sectoral contributions

(annual percentage changes; percentage point contributions)

- households
- non-financial corporations
- financial corporations
- government
- ... euro area economy



Sources: Eurostat and ECB.

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

Gross fixed capital formation, in particular of corporate capital, recovered to reach positive annual growth after six quarters of continuous negative readings. At the same time, the pace of reduction in inventories continued to decline, leading to a positive and robust increase in total capital formation (of 7.5% after five quarters of negative growth).

As in the previous quarter, the dynamics of savings were stronger than those of capital formation. This contributed to a further reduction of the euro area current account deficit (to 0.6% of GDP, on a four-quarter sum basis, see Chart B). Looking at institutional sectors, this reflects a reduction in the government deficit and an increase in the excess of corporate retained earnings over capital formation by corporations (in four-quarter sum terms), albeit much more moderate than in the previous quarter. The lending position of households declined, however, as a consequence of reduced savings and an increase in residential investment. As in previous quarters, and reflecting the weight of the government deficit, the funding of the current account deficit continued to be dominated by net inflows in debt securities.

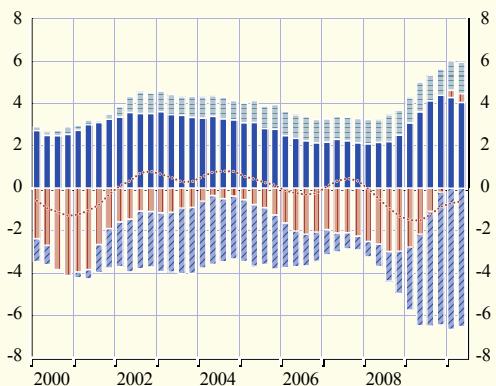
Behaviour of institutional sectors

Year-on-year growth of nominal gross disposable income of households increased to 1% (after 0.6% in the previous quarter, see Chart C) owing to an improvement in compensation of employees, dividends and net interest earned. By contrast, the contribution of net social benefits to the growth of income was lower than in the previous quarter, while tax reductions moderated further. This reflected the phasing out of the effects of the automatic fiscal stabilisers. The combination of these opposing dynamics resulted in a higher contribution to income growth from income originating directly from entrepreneurial activities (mainly compensation of employees and dividend payments) which exceeded the contribution from government distribution for the first time since the end of 2008.

Chart B Euro area net lending/net borrowing

(percentages of GDP; four-quarter moving sum)

- households
- non-financial corporations
- financial corporations
- government
- euro area economy



Sources: Eurostat and ECB.

Chart C Households' nominal gross disposable income

(annual percentage changes; percentage point contributions)

- net social benefits and contributions
- direct taxes
- net property income
- gross operating surplus and mixed income
- compensation of employees
- gross disposable income

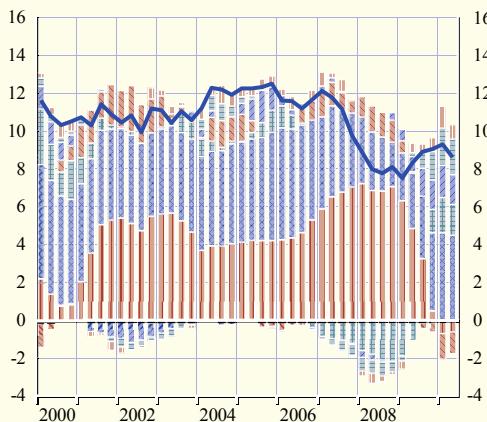


Sources: Eurostat and ECB.

Chart D Households' financial investment

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

- total assets
- M3
- deposits not included in M3
- equity
- debt securities not included in M3
- mutual fund shares (other than MMF shares)
- insurance technical reserves
- other

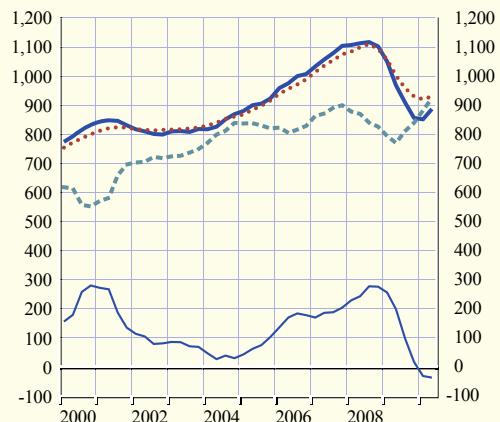


Sources: Eurostat and ECB.

Chart E NFCs' saving, capital investment, and net borrowing

(four-quarter moving sums; EUR billions)

- non-financial investment
- of which, fixed capital formation
- retained earnings and net capital transfers
- net borrowing (+)/net lending (-)



Source: Eurostat and ECB.

As in the previous quarter, the subdued increase in household nominal income was still lower than the increase in consumer prices, leading to a further reduction in real income. Moreover, more robust growth in consumption (2.4%) and the recovery in non-financial investment (which returned to positive annual growth after two years of declines) led to a further drop in the net lending position of households. This was reflected in a moderate increase in loan financing and a decline in financial investment (by 0.2 percentage points, see Chart D), all in all reflecting some portfolio shift towards housing equity. The sizeable portfolio shifts towards non-monetary assets seen since the end of 2008 continued (albeit abating slightly owing to lower investment in mutual fund shares), with deposits contributing negatively to financial investment and institutional investor liabilities contributing positively.

The year-on-year growth in the operating surplus of NFCs achieved a new record in the second quarter of 2010 (9.5%), mirroring the robust dynamics of value added. In spite of this, NFCs returned to showing net borrowing needs (excess of capital formation over retained earnings) in that quarter. This reflects an increase in non-interest property income paid (mainly distributed dividends) and in non-financial investment (fuelled by fixed capital formation, which grew at 4.2% year-on-year). External financing (total financial liabilities) increased by 1.6% year-on-year in the second quarter of 2010, having rebounded in the previous quarter after two years of continuous declines. Pronounced substitution effects can still be observed, as market financing (debt securities and quoted shares) more than offset net redemptions of MFI loans.

Chart F NFCs' external financing by source of funds

(four-quarter moving sums; EUR billions)



Source: 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, other accounts receivable/payable).

recorded a growth rate higher than in the previous quarter. These developments were mainly the consequence of the operation of automatic stabilisers in a recovering economy. At the same time, positive revenue developments were underpinned by tax increases in the context of consolidation packages introduced in many countries. The annual growth rate of financing declined moderately to 7.0% from 7.5% in the previous quarter.

Gross entrepreneurial income of financial institutions continued to grow at a high rate by historical standards, as the institutions continued to benefit from the steep yield curve. The annual growth rate of financial investment declined by 0.3 percentage points to 2.4% owing to decreasing acquisitions by investment funds in the context of the sovereign debt tensions. Debt securities, both from OFI and MFIs, were the main contributors to this development (contribution down by 0.9 percentage point) as MFIs continued to return to a more traditional bank balance-sheet composition (recording a negative annual growth rate for investment bonds for the first time). Loans granted remained subdued, with loans to households showing positive, albeit modest, growth rates and loans to NFCs showing negative rates. The ratio of equity to financial assets of MFIs declined by 0.7 percentage point to 8.1% in the context of continued disinvestment by the private sector in money market mutual fund shares.

Financial markets

Transactions in debt securities, which had been robust in previous quarters, moderated in the context of the sovereign debt tensions. NFCs reduced their issuance, reflecting a temporary shut-down of the market. Similarly, issuance by MFIs contracted so abruptly that they became buyers in net terms (acquisitions of assets minus issuances of liabilities) in spite of their continued disposals of debt securities assets. OFIs became net sellers, reflecting

NFCs leverage ratios, still historically high, have continued to decline, albeit less steeply. The debt-to-assets ratio – which can now be calculated from the new data available on non-financial assets – stabilised at 26.6% after a continuous decline since the end of 2008 (when it peaked at 28.6%), while the debt-to-gross value added ratio declined for the first time in the second quarter of 2010 owing to robust growth in value added. The ratio of net interest payments to gross value added further declined to 2.4%, also owing to the decline in the real cost of finance.

General government net borrowing was 6.5% of GDP (four-quarter moving sum), down from 6.7% in the previous quarter. This slight improvement halted the negative trend that began in 2008. It reflects slightly lower gross government investment (at 2.7% of GDP) and stable gross savings (at -3.9% of GDP). All revenue components (except direct taxes from financial corporations)

disinvestment by investment funds as the decline in household savings showed itself mainly in net disposals of mutual fund shares, reflecting a risk-averse reaction to the sovereign debt tensions. By contrast, both insurers and the rest of the world remained net buyers.

At the same time, issues of quoted shares by corporations receded somewhat, while OFI acquisitions declined markedly on the back of disinvestment by investment funds.

Balance sheet dynamics

The unfolding of the sovereign debt tensions had mixed effects on the balance sheets of financial institutions. The portfolio of debt securities increased in value owing to the high weight of safe-haven securities that benefited from flight-to-quality behaviour (Chart G). However, equity suffered from the overall increase in uncertainty that led to net holding losses (although accumulated annual flows remain at all-time records).

At the same time, the annual change in household net worth remained strongly positive (23.3% of annual income). This is mainly the consequence of holding gains on equity due to the strong overall year-on-year market rally to mid-2010 and some stabilisation in most real estate markets (Chart H).

Chart G Holding gains and losses on financial corporations' assets

(quarterly flows; EUR billions)

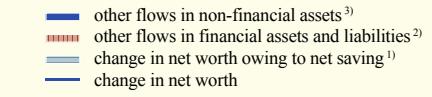


Sources: Eurostat and ECB.

Note: This chart shows 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 write-off of bad assets from the balance sheets of the creditor and the debtor upon recognition by the former that the cash flows associated with the asset can no longer be collected.

Chart H Change in net worth of households

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



Sources: Eurostat and ECB.

Notes: Data on non-financial assets are ECB estimates.

1) This item comprises net saving, net capital transfers received, and the discrepancy between the non-financial and the financial accounts.

2) Mainly holding gains and losses on shares and other equity.

3) Mainly holding gains and losses on real estate and land.