Box 2

INTEGRATED EURO AREA ACCOUNTS FOR THE SECOND QUARTER OF 2011[1]

The integrated euro area accounts up to the second quarter of 2011 that were released on 28 October 2011 offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. The latest data can be interpreted as signalling a pause in the sectoral rebalancing of financial deficits/surpluses initiated in previous quarters: the household savings rate increased somewhat, although it remained at low levels; the net borrowing of non-financial corporations (NFCs) stopped increasing; and the improvements recorded in the two previous quarters in governments' deficits were partially reversed in the second quarter. At the same time, the latest data confirm the re-intermediation movement already noted in the data for the first quarter of 2011, consistent with a smoother flow of bank credit.

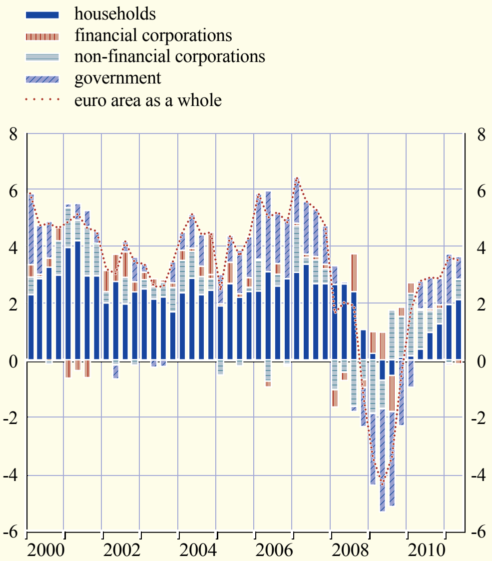
Euro area income and net lending/net borrowing

Nominal gross disposable income growth of the euro area stabilised at an annual rate of 3.5% in the second quarter of 2011, reflecting the slowdown in activity in the second quarter (see Chart A).

The fact that euro area income rose at a faster pace than consumption (including low government consumption growth of less than 1%) translated into a solid yearly increase in gross saving of the euro area. This growth in saving concerned all three non-financial sectors: governments again reduced their level of dissaving (though it still remained high), while households' saving increased in the second quarter, after a few quarters of contraction, and retained earnings of NFCs returned to positive growth in the second quarter. The growth of gross capital formation

Chart A Gross disposable income in the euro area – contribution by sector

(annual percentage changes; percentage point contributions)

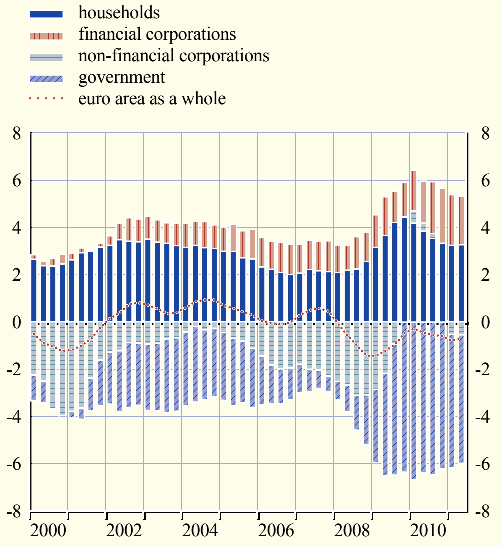


Sources: Eurostat and ECB.

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

Chart B Net lending/net borrowing of the euro area

(percentages of GDP; four-quarter moving sums)



Sources: Eurostat and ECB.

declined to 4.8%, year on year, in the second quarter of 2011, owing to less dynamic gross fixed capital formation (in part reflecting the reversal of sizeable favourable weather effects in the first quarter) and despite robust restocking.

With an increase in saving somewhat stronger than that of total investment, the net lending/net borrowing of the euro area improved (to a net borrowing of 0.7% of GDP in the second quarter of 2011, on a four-quarter sum basis). From a sectoral point of view, this reflects, on a seasonally adjusted basis, an increase in households' net lending and a reduction in NFCs' net borrowing, which compensates for a deterioration in the government balance, after two quarters marked by a swift reduction of deficits (on a four-quarter moving sum basis, however, the government deficit declined again).[2]

The mirror image of these economic developments can be seen in the external accounts, with a reduction of the external deficit that reflected improved net property income (reinvested earnings on foreign direct investment). Regarding the funding of the net financing requirement of the euro area, there were increased net inflows in debt securities, while net equity inflows moderated and net outflows in deposits remained elevated. Looking at gross exposures, cross-border transactions continued to expand by substantial amounts, in the order of €150-€200 billion per quarter (after €500-€600 billion per quarter at the peak of the boom), with strong inward inflows in debt securities, with preference being given to higher rated issuers.

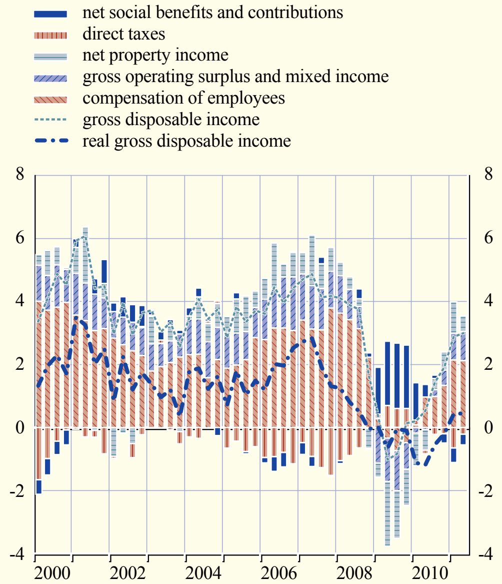
Behaviour of institutional sectors

Households' nominal income growth stabilised (+3.0%, year on year) in the second quarter of 2011, as growth in salaries and in mixed income levelled off. The significant negative contribution that income flows to and from the government (net social transfers and tax payments) make to households' income decreased in the first quarter. This merely compensated for a parallel reduction of the positive contribution of net property income earned (e.g. dividends) to households' income growth (see Chart C). Households' real income increased slightly, year on year, for the second consecutive quarter, following a period of contraction on account of, in particular, high commodity price-driven inflation (end-2010). As yearly income growth has gradually caught up with nominal private consumption growth, the further erosion of household precautionary savings came to a halt. Indeed, the household saving ratio even started to increase somewhat, to 13.9% on a seasonally adjusted basis (see Chart D), although it remained low, close to pre-crisis levels. Given that households' saving flows increased again, year on year, and that investment remained

2 The net lending/net borrowing of a sector is the balance of its capital account, which measures the excess of saving and net capital transfers received over capital investments (net lending), or vice versa (net borrowing). It is also the balance of the financial accounts, which measures the difference between transactions in financial assets and transactions in liabilities.

Chart C Households' nominal gross disposable income

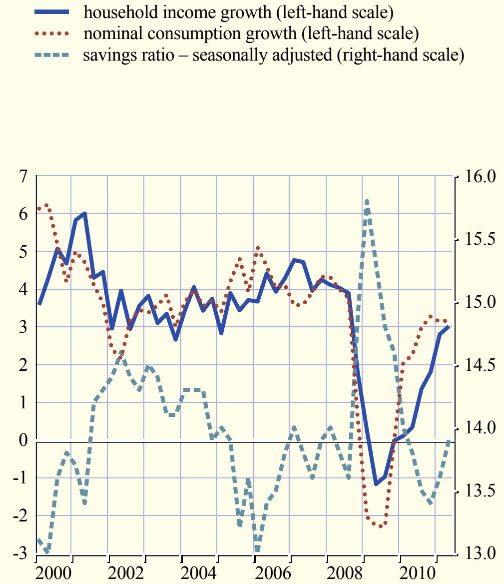
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D The growth of households' income and consumption, and their savings ratio

(annual percentage changes; percentage of gross disposable income, four-quarter moving sum)



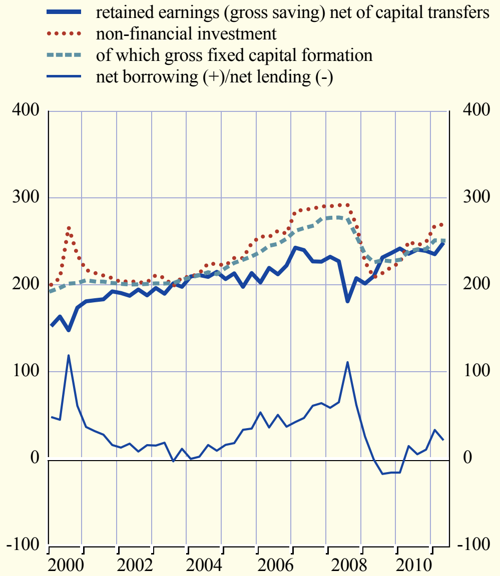
Sources: Eurostat and ECB.

subdued, their net lending position started to increase. As growth in financing decreased, financial asset accumulation by households nonetheless remained subdued, with a portfolio shift towards bank-intermediated funds being recorded.

The growth in the gross operating surplus of *NFCs* again declined markedly in the second quarter, as value added growth decelerated, while the growth of the compensation of employees remained stable. However, the increase in net property income earned and a far slower growth of corporate tax paid caused NFCs' savings to pick up again, from an already rather high level (see Chart E). With slowly increasing fixed capital investment (at still fairly depressed levels), but strong restocking, NFCs' net borrowing stabilised at moderate levels. This cautiously expansionary disposition on the part of NFCs can also be observed in the somewhat faster growth of financing on a consolidated basis. Signs of a

Chart E Non-financial corporations's saving, capital investment and net lending(-)/net borrowing(+)

(EUR billions, seasonally adjusted)



Sources: Eurostat and ECB.
Note: Seasonal adjustment by the ECB.

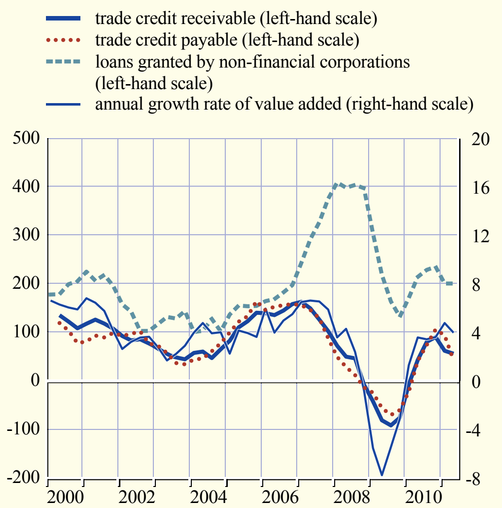
re-intermediation of NFCs' external financing were confirmed: MFI lending increased (€38 billion per quarter in the first half of 2011, the strongest net quarterly flow since the fourth quarter of 2008), with short-term loans rising particularly strongly on the back of restocking. The robust market funding and buoyant intra-sector lending (trade credit and intra-group credit) observed in 2009-10 moderated further in the first half of 2011. NFCs stepped up purchases of quoted shares, but also further augmented liquidity buffers (deposits and mutual funds).

The second quarter of 2011 saw an interruption (on a seasonally adjusted basis) of the rapid reduction of *government* deficits over the two previous quarters, as a result of a weaker growth of revenues and notably lower growth in VAT receipts. On the spending side, year-on-year growth in total expenditure remained close to zero in the second quarter, reflecting the impact of sizeable consolidation measures (including zero annual growth in compensation of employees), despite significant increases in interest payments. On a four-quarter moving-sum basis, the deficit fell to 5.5% of GDP, from a peak of 6.7% in the first quarter of 2010. Debt issuance remained elevated.

The disposable income of *financial corporations* fell, year on year, as a result of dividends paid increasing more than dividends earned, while value added plus net interest earned continued to rise. Sizeable net retained earnings (€40 billion per quarter) continued to compensate for valuation losses in recent quarters. In addition, losses on debt securities issued by some governments were in part compensated for by gains on debt securities issued by other governments. Financial corporations' net assets, measured at market value, remained high, significantly stronger than

Chart F Loans granted by non-financial corporations and their trade credit receivable and payable

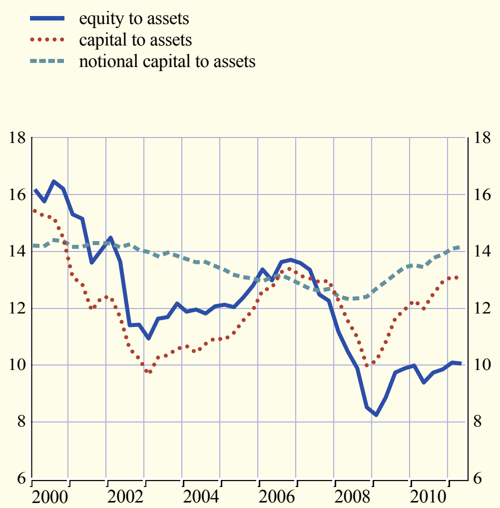
(four-quarter moving sums in EUR billions; annual percentage changes)



Sources: Eurostat and ECB.
Note: Trade credit receivable and payable are estimated by the ECB, on the basis of partial information.

Chart G Capital ratios of financial institutions excluding mutual funds

(percentage of total financial assets)



Sources: ECB.
Note: "Equity" comprises shares and other equity other than mutual fund shares. "Capital" is defined as the difference between financial assets and liabilities other than equity. All assets and liabilities are valued at market value. The "notional capital to assets" ratio is calculated on the basis of transactions in capital and assets, i.e. excluding changes in prices of assets and liabilities.

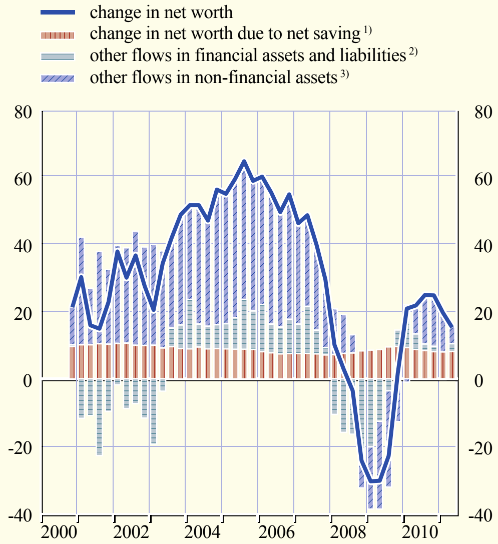
implied by their equity at market value (see Chart G). The gap between the two ratios has increased steadily since mid-2009 and suggests that the markets mistrust the sustainability of the business model of many financial institutions. In a context of deleveraging trends, additions to financial corporations' balance sheets remained modest, amounting to around €200 billion per quarter (excluding interbank transactions), compared with up to €1 trillion during the leverage boom. Finally, the pattern of pronounced financial disintermediation that emerged after the collapse of Lehman Brothers seems to be receding: households favour more intermediated funds and NFCs draw more on MFI funding to cover their external financing requirements.

Balance sheet dynamics

In the second quarter of 2011, the annual growth in households' net worth slowed down further to 15.2% of income (from 19.5% in the first quarter). Aside from the positive influence of net saving (8.1% of income), households benefited from significant holding gains (7.1% of income), most of which arose from increasing house prices, albeit at a slower pace. Overall, holding gains on financial assets remained subdued (year on year), after having been virtually non-existent in the previous quarter (see Chart H).

Chart H Change in the net worth of households

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



Sources: Eurostat and ECB.
Notes: Data on non-financial assets are estimates by the ECB.
1) This item comprises of 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.