

Box I

**RECENT DEVELOPMENTS IN LOANS TO NON-FINANCIAL CORPORATIONS**

MFI loans have traditionally represented the main source of external financing for euro area non-financial corporations, constituting around 85% of their total debt outstanding at end-2003. Given the particular importance of MFI loans for the financing of euro area firms, developments in such loans may have important implications for euro area-wide economic activity.

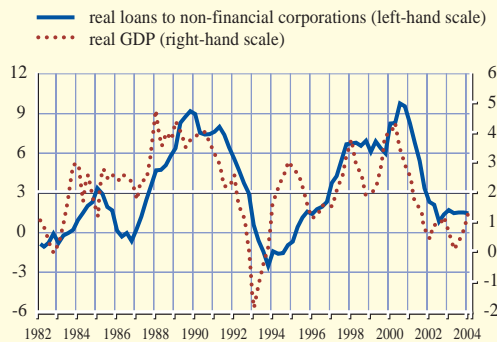
In recent years the annual growth rate of MFI loans to non-financial corporations has remained rather subdued, especially when compared with the growth rates observed between 1999 and 2001. Since mid-2002 the annual growth rate of nominal MFI loans to non-financial corporations has fluctuated in a range between 3 and 4%.

Given the business cyclical position, the current pace of loan growth is not exceptionally low by historical standards. Chart A suggests that when real GDP growth falls below its long-term average, real loan growth to non-financial corporations also tends to grow at below-average rates (with some exceptions, such as in the mid-1990s). This empirical regularity appears to have held during the period of economic weakness experienced over the past few years. The chart also suggests that corporate loan growth tends to lag behind economic growth in the euro area, which implies that current loan developments might still be reflecting past subdued economic activity.

The cross-country analysis presented in Chart B confirms the effect of business cycle conditions on developments in loans to non-financial corporations in recent years. The chart plots the average annual growth rate of nominal GDP between 2001 and 2003 against the average annual growth rate of loans to non-financial corporations over the same period. A positive overall correlation between the growth of loans to non-financial corporations and economic growth is visible.

**Chart A Real loans to non-financial corporations and real GDP**

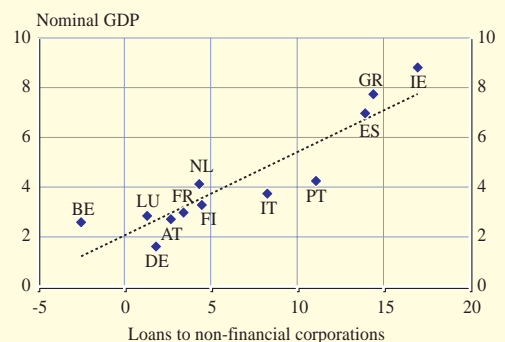
(annual percentage changes)



Source: ECB.  
Note: The horizontal line indicates the average rate of growth of real loans to non-financial corporations (deflated by the GDP deflator) and real GDP over the period Q1 1982 - Q1 2004 (3.1% and 2.1%, respectively).

**Chart B Loans to non-financial corporations and GDP in the period 2001-2003**

(annual percentage changes, period average)



Source: ECB.  
Note: The dotted line denotes a linear interpolation. The chart plots the average annual growth rate of nominal GDP between 2001 and 2003 against the average annual growth rate of loans to non-financial corporations over the same period.

It is important to bear in mind that the analyses presented in Charts A and B do not take into account the effect of other variables likely to influence loan developments, notably the real cost of financing. Following the shift to a regime of low and stable inflation, bank lending interest rates in the euro area have over recent years fallen – in real terms – to their lowest levels since the early 1980s. A permanent decrease in the average real cost of loans may be expected to be accompanied by a structural rise in the volume of real loans to non-financial corporations.

At the same time, in recent years a number of factors are also likely to have had a moderating influence on corporate loan growth. First, the persistence of a sizeable debt overhang accumulated during the 1999-2001 period may have weighed down loan growth in more recent years. However, the overall magnitude of the impact of debt overhang on loan growth remains unclear. While its impact may be relevant for the financially weakest small and medium-sized enterprises and for highly leveraged firms in some specific sectors, the fact that non-financial corporations as a whole are continuing to accumulate liquid assets at a high pace (see Chart C9 in the appendix on “Euro area statistics”) would not indicate that firms are constrained at the aggregate level in their access to financing.

Second, it cannot be ruled out that some firms may have taken advantage of the relatively low cost of issuing debt throughout 2003 to “pre-fund” their financing needs via debt securities issuance (see Chart 8 of the main text).

Third, improving corporate profitability in recent quarters (as indicated, for instance, by the actual earning per share for corporations included in the Dow Jones EURO STOXX broad index) suggest that the availability of internal funds to firms may have increased, thereby reducing their demand for bank loans.

Fourth, it needs to be kept in mind that the emergence of an area-wide corporate bond market and the rapid growth of financial intermediation via non-monetary financial institutions over the past few years have led to the debt of non-financial corporations becoming more diversified.<sup>1</sup> Indeed, over the last few years, the growth of total debt financing of the non-financial corporate sector has always been higher than the rate of loan growth (see Table 4 in the main text).

To sum up, various factors may explain the current subdued growth of loans to non-financial corporations. These include, first of all, the current business cycle position. More recently, the increased availability of internal funds may have also contributed to a reduction in the demand for loans – and financing in general – by non-financial corporations. In this respect, the fact that non-financial corporations have continued to accumulate liquid assets at a rapid rate indicates that the sector as a whole is not constrained in its funding for new investment projects in the current climate of economic upswing. This rapid accumulation of liquid holdings would instead seem to indicate that, on average, the corporate sector has decided to “wait and see”, waiting for higher demand before starting again to invest more in fixed capital. Seen from a longer-term perspective, the current growth rates of loans may also reflect the emergence of alternative forms of debt financing.

<sup>1</sup> See the article entitled “Developments in the debt financing of the euro area private sector” in the November 2003 issue of the Monthly Bulletin.