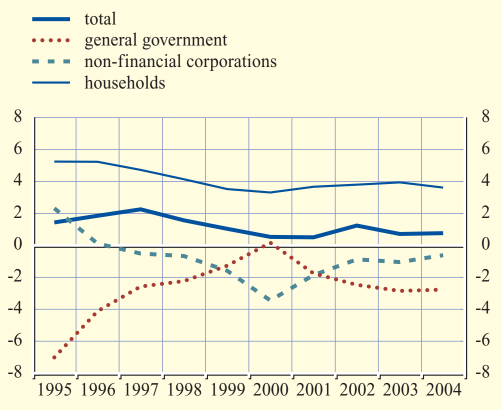
Box 3

SAVING, FINANCING AND INVESTMENT OF EURO AREA HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS IN 2004

Euro area annual financial accounts data for 2004 have recently become available.[1] These data supplement the information provided in the quarterly national accounts, as they allow for a more comprehensive analysis of the financial positions and developments in the individual euro area sectors. Overall, the net lending positions of the respective sectors changed only slightly in 2004 compared with the previous year. The combined net balance of the domestic sectors vis-à-vis the rest of the world remained positive, essentially reflecting a continued large net lending position on the part of households, while non-financial corporations and general government maintained a net borrowing position (see Chart A). This box discusses developments in saving, financing and financial investment underlying these net lending/borrowing positions, focusing on households and non-financial corporations.

Chart A Net lending/net borrowing of sectors[1)]

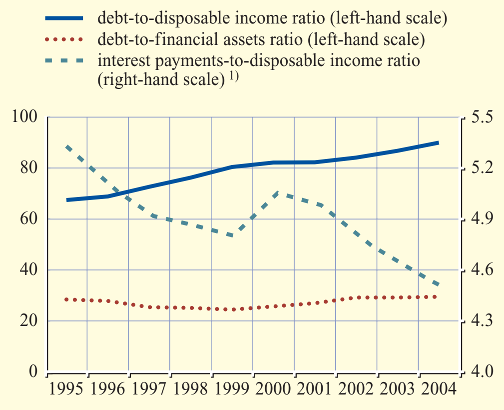
(as a percentage of GDP)



Source: ECB.
1) Net lending/net borrowing is defined as gross saving and net capital transfers received minus gross capital formation and net acquisition of valuables.

Chart B Debt and interest payment burden of households

(percentages)



Source: ECB.
1) Interest payments for 2004 are an ECB estimate.

Households

The net lending position of households receded slightly in 2004, mainly reflecting an increase in gross fixed capital expenditure, which was to a large extent due to the net acquisition of

1 See Section 3.4 of the "Euro area statistics" section of this issue of the Monthly Bulletin. Euro area financial accounts data are compiled by the ECB and are based on national financial accounts.

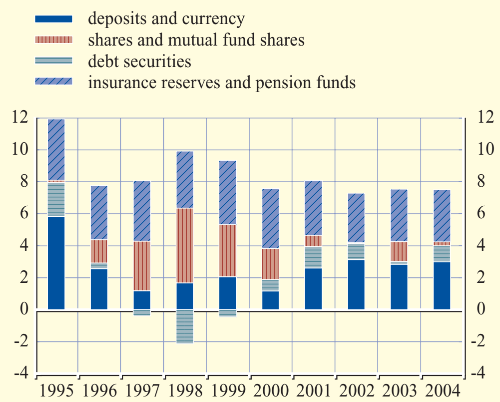
housing property. Households' gross savings as a percentage of GDP remained broadly unchanged at around 10%.

In 2004 households further increased their demand for loans for house purchase,[2] resulting in a further rise in the ratio of household debt to disposable income (see Chart B). When assessing this rising indebtedness, a number of factors should be taken into account. For instance, the debt-to-disposable income ratio in the euro area remained far below that in other industrialised countries such as the United States, the United Kingdom or Japan. Moreover, the debt-to-financial assets ratio remained stable, as the value of deposits and currency, as well as assets held in pension funds (insurance technical reserves), also increased. In addition, the rise in mortgage debt was accompanied by a rise in house prices. Despite the rise in indebtedness, the overall gross interest payment burden of euro area households decreased further in 2004 in a context of low interest rates.

The financial investment of households as a percentage of GDP remained broadly stable in 2004, but this conceals somewhat different movements in the underlying components (see Chart C). The contribution of investment in insurance reserves and pension funds, which tends to display only relatively small movements over time, was unchanged. The contribution of flows into deposits and currency was also broadly similar to that observed in previous years, although there was a slight increase compared with 2003. At the same time, there were more or less offsetting movements in terms of a rising contribution from the net acquisition of debt securities and a declining contribution from the purchase of shares and mutual fund shares. In each case these movements implied a reversal of developments observed in 2003.

Chart C Financial investment of households[1)]

(as a percentage of GDP)



Source: ECB.
1) Excluding financial derivatives and other accounts receivable.

Non-financial corporations

The net borrowing position of non-financial corporations – an indicator of the investment spending that needs to be financed out of external rather than internal funds – decreased to -0.6% of GDP in 2004, compared with -1.0% in 2003. This development was essentially driven by the fact that, in an environment of solid corporate profits and relatively subdued non-financial investment activity, the increase in gross savings outpaced the increase in gross capital formation between 2003 and 2004.

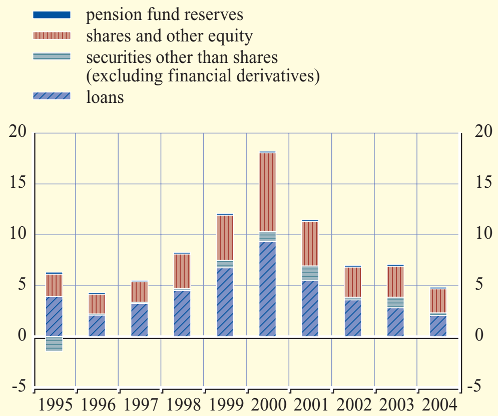
Reflecting the fact that the borrowing needs of non-financial corporations were dampened by their strong profits, the net incurrence of liabilities by non-financial corporations as a

2 It should be noted that a large percentage of housing transactions financed by loans do not translate into an increase in net capital formation (which has been subdued or negative since the mid-1990s) because it takes place on the secondary market, mainly as transactions between households.

percentage of GDP decreased between 2003 and 2004. This decrease largely reflected a decline in all three main types of liabilities: loans, debt securities and equity (see Chart D). The reduced contribution of loans to non-financial corporations was mainly caused by a sharp drop in lending by non-MFIs, which counteracted the increase in loans granted by MFIs. Some of the decrease in these non-MFI loans may be attributable to changes in the tax regulations of one euro area country, which gave rise to some replacement of inter-company loans with unquoted equity. However, the contribution of the overall issuance of equity decreased in 2004, largely driven – as in previous years – by the contribution of unquoted shares and other equity issuance. Furthermore, it is worth noting that the contribution of quoted shares issuance increased in 2004, reinforcing the upward trend observed since 2002.

Chart D Financing of non-financial corporations[1]

(as a percentage of GDP)

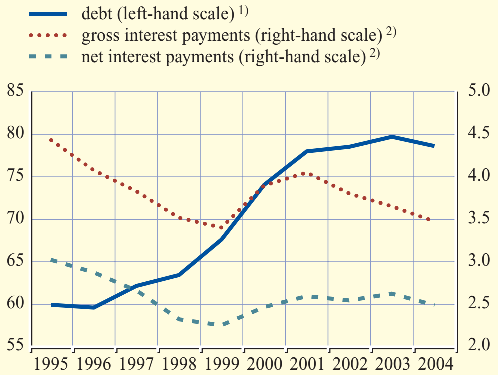


Source: ECB.
1) Excluding financial derivatives and other accounts payable.

The debt-to-GDP ratio for non-financial corporations decreased slightly in 2004 for the first time since the late 1990s (see Chart E). According to the latest estimates, the burden of gross

Chart E Debt and interest payments of non-financial corporations

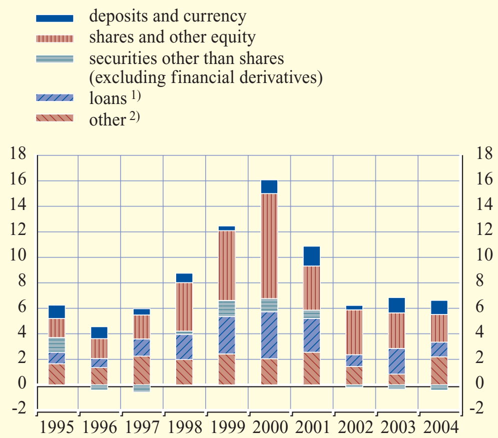
(as a percentage of GDP)



Source: ECB.
1) Debt includes loans, securities other than shares (excluding financial derivatives) and pension fund reserves. These data, compiled on the basis of the annual financial accounts, show the ratio of debt to GDP as being somewhat higher than would be the case were they based on the quarterly financial accounts, mainly because of the inclusion here of both loans granted by banks outside the euro area and a higher coverage of loans granted by non-financial sectors.
2) Interest payments for 2004 are an ECB estimate.

Chart F Financial investment of non-financial corporations

(as a percentage of GDP)



Source: ECB.
1) "Loans" comprise mainly inter-company loans.
2) "Other" financial investment includes net other accounts receivable, net financial derivatives and insurance technical reserves.

interest payments to MFIs and non-MFIs as a percentage of GDP declined further in 2004 owing to the low level of interest rates. The interest payment burden also decreased on a net basis in 2004, which reflects the fact that the interest received by non-financial corporations as a percentage of GDP remained unchanged between 2003 and 2004.

While the financial investment of non-financial corporations as a percentage of GDP remained broadly unchanged in 2004, there were some changes in its composition (see Chart F). Continuing the broad downward trend observed since 2000, the contributions of inter-company loans and of shares and other equity decreased, the latter possibly reflecting subdued mergers and acquisitions activity in 2004. Moreover, non-financial corporations remained net sellers of debt securities. These decreases in loans and securities were offset by an increase in the contribution of other financial investment in 2004, notably other accounts receivable such as trade credits and advances. The contribution of holdings of deposits and currency remained broadly unchanged at the relatively high level of the previous year, probably an indication that the demand for overnight deposits continued to be supported by the very low opportunity cost of holding these liquid instruments.