Box 3

INTEGRATED EURO AREA ACCOUNTS FOR THE FOURTH QUARTER OF 2008

This box presents the integrated euro area accounts (EAA) released on 30 April 2009 on the website of the ECB.[1] The released EAA provide comprehensive information on the income, spending, financing and portfolio decisions of each sector of the euro area economy up to the fourth quarter of 2008. They reflect how economic agents reacted to the intensification of the financial crisis, the associated rise in uncertainty and the contraction of global activity. The EAA offer three main benefits. First, they include new information not previously reported, in particular on the non-financial private sectors (households and non-financial corporations). Second, they contain consistent information on each institutional sector taken as a whole, integrating the financial and non-financial sides of the accounts. Third, they bring together the data within a unified framework, thus enhancing the scope for analysing interactions between financial and real economy variables as well as interrelations across institutional sectors.[2]

As the mild cyclical slowdown in economic activity observed until the summer of 2008 abruptly turned into a pronounced contraction by year-end, euro area year-on-year growth in nominal disposable income came to a standstill in the fourth quarter of 2008, affecting all sectors but with different intensity, and in particular households and government.

Behaviour of institutional sectors

The marked slowdown in (hitherto robust) *household* nominal income growth in the fourth quarter of 2008 reflected a sudden deceleration in the compensation of employees and in self-employment income, as well as an abrupt contraction in property income received. These negative impacts were only partially mitigated by a further deceleration in paid taxes. Thus, despite a sharp reduction in the consumption deflator (from 3.9% year on year in the third quarter of 2008 to 1.9% in the fourth quarter of 2008), growth in household real disposable income remained at the sluggish pace of the previous two quarters (0.7% year on year, the lowest annual growth rate since 2003). Increased uncertainty about the economic outlook and prospects for employment and housing markets, combined with a steep drop in household net financial wealth (due to holding losses on shares), led households to deepen their real consumption retrenchment and to further increase saving, pushing their saving rate up to 14.2% in the fourth quarter of 2008 (on a four-quarter moving sum basis). Coupled with falling household investment (in housing), this led to a further rise in their net lending, contributing to a reduced need for loan borrowing. On the asset side, the intense economic and financial uncertainty increased households' preference for liquidity, as they continued redeploying their financial investment in favour of currency and deposits, reducing their holdings of riskier assets (quoted shares, mutual fund shares) and slowing their accumulation of less liquid assets (insurance technical reserves) – see Chart A.

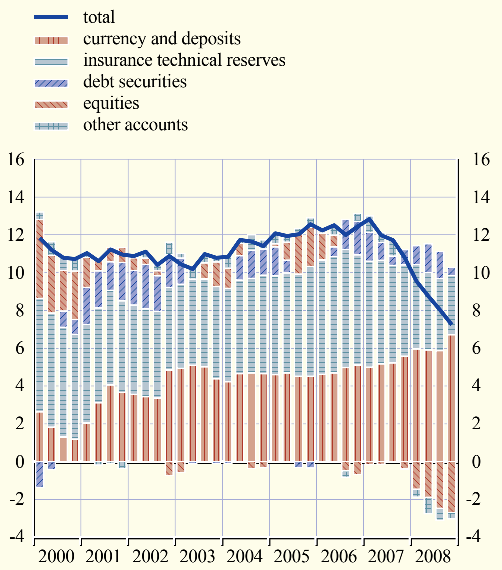
Under the impact of the pronounced contraction in activity in the fourth quarter of 2008, nominal value added of *non-financial corporations* (NFCs) was flat year on year. NFCs quickly reacted by containing compensation of employees (reflecting largely a "volume" effect: reduction in employment as well as in hours worked per employee), thereby limiting the negative impact on

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

2 For an introduction to the EAA, see the article entitled "The introduction of quarterly sectoral accounts statistics for the euro area" in the November 2007 issue of the Monthly Bulletin.

Chart A Households' financial investment

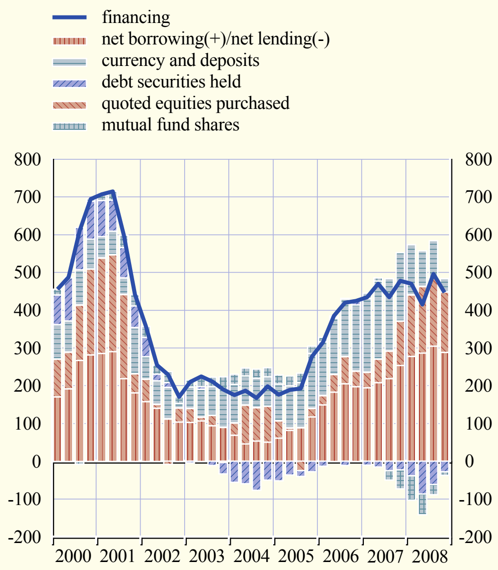
(annual percentage changes; percentage point contributions)



Source: ECB.

Chart B NFCs' financing and their use of funds

(four-quarter moving sum; EUR billions)



Sources: ECB and Eurostat.
Note: For presentational purposes, some transactions in assets are netted from financing, as they are predominantly internal to the sector (loans, unquoted shares, other accounts receivable/payable).

overall margins (the gross operating surplus fell by 4.1% year on year, compared with +1.6% in the third quarter of 2008). NFCs' saving even exhibited positive growth, supported by a fall in dividends and direct taxes paid. Against the background of shrinking global demand and a drop in capacity utilisation, coupled with tighter financial conditions, the annual growth of NFCs' capital formation abruptly turned negative (-3.3% year on year) after a long period of resilience (+7% in the year to the third quarter of 2008). Owing to these swift adjustments, NFCs managed to decrease their net borrowing in the fourth quarter of 2008, despite the adverse impact of the recession, after a long period of increased reliance on external financing as can be seen in Chart B. NFCs also substantially reduced their purchases of quoted equity in the fourth quarter of 2008, in sharp contrast to increasing purchases up to the third quarter of 2008, and limited share buybacks. In addition, NFCs further drew down their liquidity buffers, despite a widespread scramble for cash, as companies' accumulation of deposits decelerated sharply and net disposals of debt securities and mutual fund shares continued, albeit at a reduced pace (see Chart B). The annual growth rate of external financing of NFCs slowed further, but loan financing remained sizeable, owing to the NFCs' need to finance their still high net borrowing position and also reflecting a drawing-down on open credit lines previously established and other prearranged financing. The freeze in the debt securities market in the weeks after the Lehman Brothers bankruptcy was followed by a reopening of the market and by an increase in issuance towards the end of the year, albeit at higher yields. Thus, the growth rate of issuance of debt securities increased in the quarter, in part reflecting tighter bank credit conditions.

The rapid deterioration of *general government* accounts largely reflected the impact of automatic stabilisers in a slowing economy, with a sharp decline in direct taxes on NFCs, falling indirect taxes, and muted growth in direct taxes on households. Treasuries considerably stepped up debt issuance in the fourth quarter of 2008, in order to finance actual deficits as well as large asset purchases (of loans, debt securities and unquoted equity) carried out in the context of financial rescue measures (around €190 billion in the fourth quarter of 2008 alone).

The disposable income of *financial corporations* contracted – though remaining at elevated levels – owing to reduced dividend income (whilst still paying out sizeable dividends), even though their gross operating surplus rebounded, owing to increasing lending margins and to a marked slowdown in compensation of employees. In the context of ongoing deleveraging, quarterly additions to their balance sheet slowed down considerably (€100 billion per quarter compared with up to €1 trillion previously). In the fourth quarter as a whole, the sector's holding losses on structured assets were compensated for by gains on its holdings of government securities.

Euro area income and net lending/net borrowing

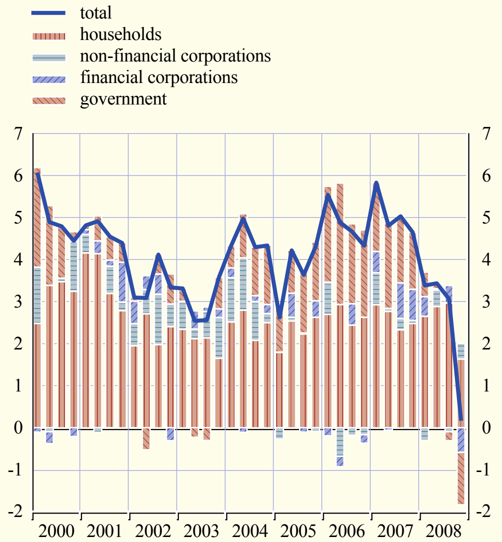
The euro area (nominal) gross disposable income growth came to an abrupt standstill in the fourth quarter of 2008 (to +0.2% year on year from 3.1% in the third quarter of 2008), reflecting the fall in nominal GDP growth. This very sharp deceleration impacted mostly on government and households, while NFCs reported a rebound in income. The resilience of household gross domestic income growth that had been observed in previous quarters receded, growing by 2.5% year on year in the fourth quarter, down from 4.6% in the third quarter. As a result of automatic stabilisers, government gross disposable income fell sharply by 4.9% year on year in the fourth quarter of 2008, a rapid decline, compared with -1% in the third quarter of 2008 and +2.9% in the first quarter of 2008. The disposable income of financial corporations fell sharply (see Chart C).

The contraction in euro area gross saving accelerated in the fourth quarter of 2008 (-7% year on year), as the sharp decline in government's and financial corporations' saving exceeded the increase in households' saving. Growth in euro area gross fixed capital formation abruptly turned negative in the fourth quarter of 2008. NFCs' fixed investments contracted by 5.5% in the year to the fourth quarter of 2008, after remaining relatively resilient previously (+5.4% up to the third quarter of 2008), with companies forcefully scaling down projects amid tightening financial conditions and a deterioration in demand prospects. Household fixed investment (residential investment and capital formation by unincorporated businesses) further declined by 5.5% year on year.

As saving contracted more than investment, euro area net lending/net borrowing (which turned negative in the second quarter of 2008)

Chart C Euro area gross disposable income – contribution by sectors

(annual percentage changes; percentage point contributions)

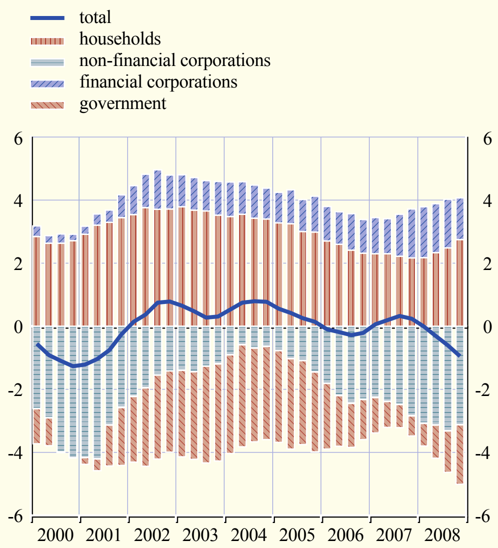


Sources: Eurostat and ECB.

continued to deteriorate, to a deficit of -0.9% of GDP on a four-quarter moving sum basis. Euro area net borrowing over the past year is the mirror image of the euro area current and capital account deficit. This worsening, despite the favourable impact of falling commodity prices at the end of 2008, resulted from a marked volume contraction in net exports, as external demand cooled rapidly, as well as from falling net property income received. From a sectoral point of view, the deterioration in euro area net lending/net borrowing reflected the sharp increase in government net borrowing, which exceeded the increase in household net lending and the reduction in NFCs' net borrowing (see Chart D).

Chart D Euro area net lending/net borrowing

(as a percentage of GDP; four-quarter moving sum)



Sources: Eurostat and ECB.

Thus, the euro area as a whole again exhibited a net financing requirement in the year to the fourth quarter of 2008, mirroring the saving-investment balance on the non-financial side. The protracted financial turbulence led to a considerable slowdown in gross cross-border transactions. The net deposit inflows, which were still high in the first three quarters, fell considerably in the fourth quarter, as cross-border interbank flows froze after the Lehman Brothers bankruptcy. However, this was in part offset by accelerated net inflows in debt securities. "Net" annual outflows of equity securities continued, while net loan outflows slowed (and turned into an inflow in the fourth quarter alone).

Non-financial sector financing and financial markets

The annual growth rate in the total financing of the non-financial sectors rebounded somewhat in the fourth quarter of 2008 on a moving sum basis on the back of a very active government debt issuance, while non-government financing continued to slow down.[3] On the financial investment side, the net acquisition of financial assets by the non-financial sectors picked up in the fourth quarter of 2008, owing to an exceptionally large build-up of assets by government, mostly related to financial rescue operations. In contrast, the net acquisition of financial assets by households and NFCs slowed further.

From an instrument perspective, in the debt securities market, while government massively increased net issuance, MFIs became net buyers as they resumed purchases and as net issuance turned negative. The rest of the world also increased its net purchases, while households became sellers and insurance corporations and pension funds slowed purchases. On the mutual funds market, net redemptions of non-money market mutual fund shares accelerated and the rest of the world became a net seller. On the quoted shares market, NFCs slowed purchases, while MFIs and households remained large net sellers.

3 The annual growth rate of total financing available from the EAA is more subdued than the growth rate of the financing components available from the ECB's money and banking statistics and securities issuance statistics owing to broader coverage as well as to other methodological differences.

Balance sheet dynamics dominated by holding losses

In the context of slow financing growth rates across the board, movements in balance sheets were dominated by holding losses. Falling global equity prices had an adverse effect on the net financial wealth of households, to the cumulative amount of €1.5 trillion in the year to the fourth quarter of 2008. On the bond market, the increase in prices of government bonds (and in the value of the US dollar) in the second half of 2008 offset the large write-downs on "toxic assets". It should be recalled that, concerning loans, which are valued in the system at nominal value, impairment only leads to an impact on the financial wealth of creditors when they are actually written off, thus generally with a noticeable delay.