

EXTERNAL FINANCING OF NON-FINANCIAL CORPORATIONS IN THE EURO AREA AND THE UNITED STATES

This box analyses the main developments in and the composition of the external financing of non-financial corporations in the euro area and the United States, mainly based on the euro area accounts and the US flow of funds accounts.¹ External financing is defined broadly in this box and includes all liabilities of the non-financial corporate sector. At the same time, some adjustments have been made in order to facilitate the comparison between the euro area and the United States.²

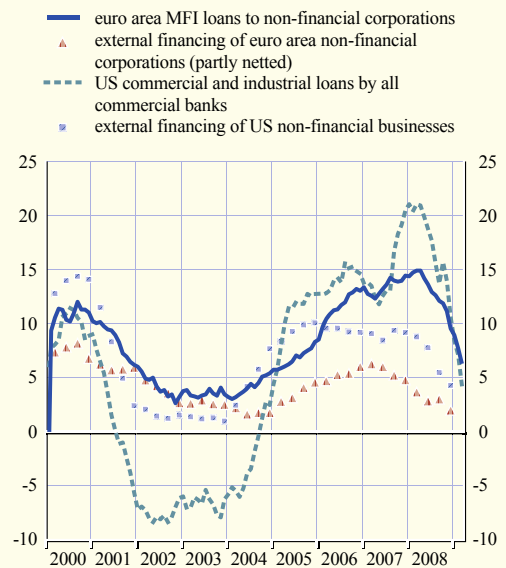
External financing growth developments

Growth in the external financing of non-financial corporations has slowed down considerably in the euro area and the United States during recent quarters, broadly in parallel with the decline in economic activity. For non-financial businesses in the United States, the annual growth rate of external financing declined from 9.4% in the third quarter of 2007 to 4.3% in the fourth quarter of 2008. Similarly, the annual growth rate of the external financing of euro area non-financial corporations declined from a peak of 6.3% in the first quarter of 2007 to 2.0% in the fourth quarter of 2008. This compares with an average annual growth rate of external financing from 2000 until 2008 of 7.0% for US non-financial businesses and of 4.4% for euro area non-financial corporations.

The decline in the external financing growth of euro area non-financial corporations was mainly related to the strong decrease in the annual growth rate of bank lending, which dropped from a peak of 14.9% in early 2008 to 6.3% in March 2009. In the United States, bank loans are overall less important for the total external financing of non-financial businesses (see the next section of this box). However, similar developments to those in the euro area were observed, with the

Chart A External financing growth of non-financial corporations in the euro area and the United States

(annual percentage changes)



Sources: Board of Governors of the Federal Reserve System and ECB.

Notes: External financing refers to the total liabilities of non-financial corporations. In order to facilitate the comparison with the United States, shares and other equity have been consolidated by netting out non-financial corporations' equity investment for euro area non-financial corporations. In addition, inter-company loans have been consolidated by netting out intra-euro area loans granted by non-financial corporations.

1 See also the article entitled "The external financing of households and non-financial corporations: a comparison of the euro area and the United States" in the April 2009 issue of the Monthly Bulletin and the box entitled "Integrated euro area accounts for the fourth quarter of 2008" in the May 2009 issue of the Monthly Bulletin. For the United States, the non-financial business sector is referred to, as this is the sector which is most comparable with the euro area non-financial corporate sector. See the box in the above-mentioned Monthly Bulletin article for further explanations of statistical differences between the euro area and the United States.

2 In order to facilitate the comparison with the United States, shares and other equity have been consolidated by netting out non-financial corporations' equity investment for euro area non-financial corporations. In addition, inter-company loans have been consolidated by netting out intra-euro area loans granted by non-financial corporations.

annual growth of commercial and industrial loans dropping from a peak of 21.1% in early 2008 to 4.3% in March 2009. This compares with an average annual growth rate from 2000 until 2008 of 8.5% for MFI loans to euro area non-financial corporations and of 5.7% for commercial and industrial loans in the United States. The strong decline in bank loan growth in both economic areas was related to the sharp slowdown in economic activity and a significant tightening of credit standards in the course of the financial turmoil, whereas financing conditions for non-financial corporations had been very favourable over an extended period before the turmoil. In addition to the deterioration in the economic outlook, banks' balance sheet conditions and the increase in their cost of funding during the financial turmoil contributed to the tightening of credit standards for bank loans to enterprises. At the same time, the acceleration of the annual growth rate of bank loans until early 2008, especially in the United States, is likely to have been related to substitution effects, as market-based financing has been seriously hampered during the financial turmoil (see also the next section).

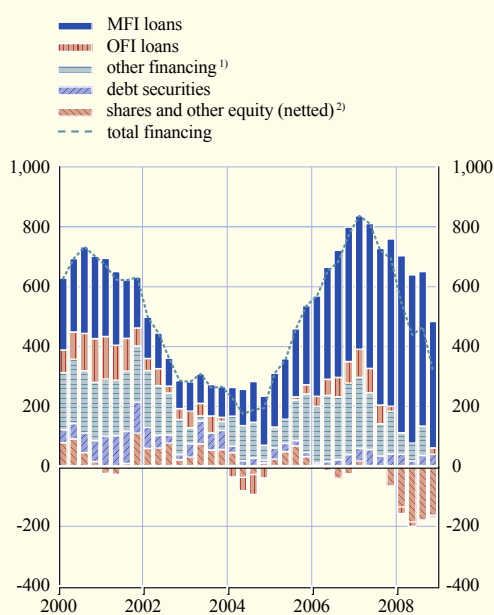
Composition of external financing

When breaking down the external financing of non-financial corporations into the financing components, major differences can be detected between the external financing of non-financial corporations in the euro area and non-financial businesses in the United States.

Starting with the euro area, MFI loans traditionally account for the bulk of the external financing of non-financial corporations (see Chart B). In an environment of favourable bank lending conditions, their share stood at 60% (based on annual transactions) in the second quarter of 2007, i.e. before the onset of the financial turmoil, and at 56% on average from 2000 to 2008. Compared with MFI loans, debt securities issued by non-financial corporations and loans by other financial intermediaries (OFIs) are of more limited importance for the external financing of euro area non-financial corporations, representing a share of 10% and 6% of external financing on average from 2000 to 2008, respectively. In order to facilitate the comparison with the United States, the accounting convention of netting the issuance of equity by euro area non-financial corporations with their equity investment has been applied. This consolidation considerably reduces the importance of equity, to a relatively low proportion of the external financing of the non-financial corporate sector, as non-financial corporations are important holders of equity issued by the same sector. By comparison, in the unconsolidated view, shares and other equity account for 32% of the total liabilities

Chart B Breakdown of the financing of non-financial corporations in the euro area

(four-quarter moving sum of transactions; EUR billions)



Source: ECB.

1) "Other financing" includes other accounts payable, financial derivatives and financing through direct pension commitments. In order to facilitate the comparison with the United States, inter-company loans have been consolidated by netting out intra-euro area loans granted by non-financial corporations.

2) In order to facilitate the comparison with the United States, shares and other equity have been consolidated by netting out non-financial corporations' equity investment.

of non-financial corporations, mainly owing to unquoted equity. “Other financing” of euro area non-financial corporations, largely made up of “other accounts payable”, which also includes trade credit, accounted for 28% of external financing on average from 2000 to 2008.

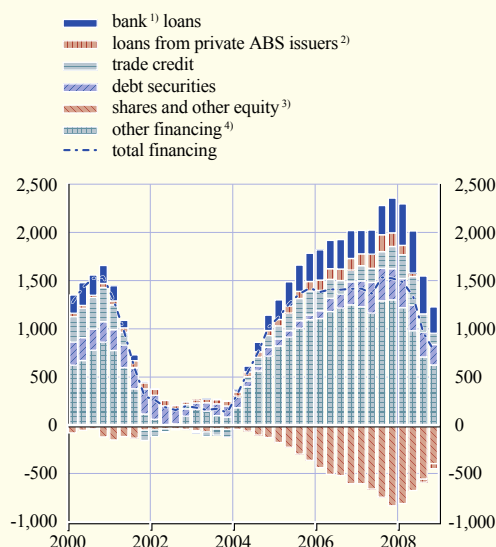
From the third quarter of 2007 to the fourth quarter of 2008 (the latest period for which data are available for the euro area accounts), when the financial turmoil intensified after the Lehman Brothers bankruptcy, market-based funding of non-financial corporations, including securitisation, was seriously hampered. This led to a further increase in the importance of MFI loans in the external financing of euro area non-financial corporations, to a ratio of more than 100% (based on annual transactions) on average over this period, which was related to negative net transactions in other financing instruments. The decrease in the importance of OFI loans (which accounted for an average share of 1.5% of external financing in the period under review) to, in some quarters, negative net transactions is likely to have been related to

the decline in the true-sale securitisation activity and syndicated lending activity of non-financial corporations during the financial turmoil. While the issuance of debt securities by non-financial corporations was also negatively affected by the financial turmoil, transactions remained mostly positive at relatively low levels (with an average share of 7% from the third quarter of 2007 to the fourth quarter of 2008). Net equity issuance turned strongly negative, owing to an increase in equity acquisitions, whereas equity issuance declined over the period. Moreover, there was a downward shift in the share of “other financing” of euro area non-financial corporations to 14% on average. Both trade credit between non-financial corporations, which declined broadly in parallel with the economic slowdown, and financial derivatives, which were considerably affected by the financial turmoil, decreased between the third quarter of 2007 and the fourth quarter of 2008.

Turning to the United States, bank loans are of considerably lower importance in the external financing of non-financial businesses than in the euro area (see Chart C). On average from 2000 to 2008, bank loans accounted for a share of 14% of the external financing of US non-financial businesses. Compared with the euro area, debt securities issued by non-financial businesses play a much larger role in external financing (31% on average from 2000 to 2008), indicating that the United States has a more market-based financial system compared with the bank-based financial system in the euro area. In addition, loan securitisation and loan syndication gained considerable importance for US non-financial businesses during the years up to the financial turmoil. First, this is indicated by the share of loans from private issuers of asset-backed securities (11% in the second quarter of 2007, compared with 6% on average from 2000 to 2008). Second, “other financing”, which includes among other items non-bank loans to non-financial businesses, increased in the few years prior to the financial turmoil. In part, the considerable importance

Chart C Breakdown of the financing of non-financial businesses in the United States

(four-quarter moving sum of transactions; USD billions)



Source: Board of Governors of the Federal Reserve System.
 1) Commercial banks, savings institutions and credit unions.
 2) Loans from private asset-backed securities issuers.
 3) Net issuance of shares and other equity minus net acquisition of shares and other equity.
 4) No further breakdown available.

of “other financing” in the external financing of US non-financial businesses may reflect the importance of securitisation, possibly related to accounting standards which, by comparison with the euro area, allow an easier removal (derecognition) of loans from bank balance sheets when loans are sold to non-banks during the securitisation process, as well as syndicated lending. At the same time, such differences in external financing between the euro area and the United States also reflect different financial market structures in the two economic areas. Finally, owing to equity acquisitions in the context of share buybacks and mergers and acquisitions, the equity issuance of US non-financial businesses was negative over the period under review.

As in the euro area, bank loans gained in importance in the external financing of US non-financial businesses during the financial turmoil, related to the more difficult environment for market-based funding, including securitisation. The ratio of bank loans to the total external financing of non-financial businesses rose to 30% on average from the third quarter of 2007 to the fourth quarter of 2008, up from 18% in the second quarter of 2007. Substitution effects are likely to be more relevant in the United States than in the euro area, owing to the greater importance of debt securities issued by US non-financial corporations than those issued by euro area non-financial corporations. In addition, loans from private issuers of asset-backed securities and “other financing” (based on annual transactions) declined considerably over this period, reflecting the seriously hampered market conditions for securitisation and syndicated lending. As in the euro area, trade credit between non-financial businesses fell considerably towards the end of 2008, related to the decline in economic activity. Finally, the equity issuance of non-financial businesses remained negative, but to a lesser extent, which may be related to less favourable conditions for share buybacks and mergers and acquisitions in an environment of reduced corporate profitability.

Conclusion

Overall, the financial turmoil has had a considerable impact both on the size and the composition of the external financing of non-financial corporations in the euro area and the United States. In both economic areas, bank loans gained in importance as a ratio of total external financing, owing to the more seriously hampered market conditions for market-based financing, notably securitisation. This development may have been more pronounced in the United States than in the euro area, owing to the higher importance of debt securities issued and the easier conditions for derecognising loans from banks’ balance sheets in the US.