

Box 2

INTEGRATED EURO AREA ACCOUNTS FOR THE THIRD QUARTER OF 2009¹

The integrated euro area accounts for the third quarter of 2009 released on 28 January 2010 offer comprehensive and consistent information on the income, spending, financing and portfolio decisions of all sectors of the euro area economy.

Euro area income and net lending/net borrowing

As the euro area economy resumed moderate growth in the third quarter of 2009, the year-on-year contraction of the nominal gross disposable income of the euro area as a whole slowed to -2.3% from -3.7% in the previous quarter. Non-financial corporations returned to positive income growth after the decline in the previous quarter. Households' income growth decreased again, mainly reflecting further reductions in compensation of employees. Government disposable income declined year on year, though at a slower pace. Financial corporations' disposable income fell sharply (see Chart A).

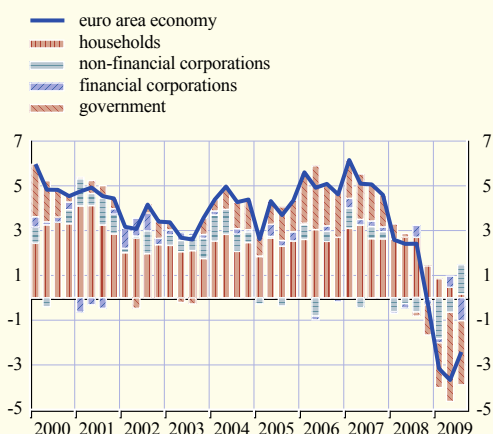
Euro area gross saving rebounded in the third quarter of 2009, mainly on account of rising savings of non-financial corporations. The very rapid 16.3% year-on-year decline in euro area savings observed in the second quarter of 2009 moderated to -10.5%. Gross capital formation also shrank less strongly year on year, with an annual change of -12% (from -13.5% in the second quarter), due to a deceleration in the decline in capital expenditure by the private non-financial sectors, whilst year on year growth in government investment, although still robust, decreased.

As a result of the marked inflection in savings, coupled with a less marked one in capital formation, the external balance continued to improve. This result also reflected falling net

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

Chart A Euro area gross disposable income – contribution by sector

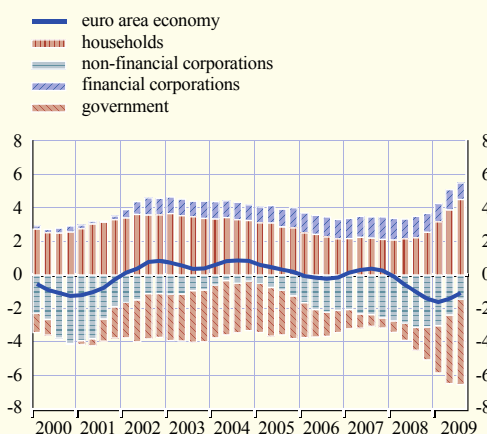
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart B Euro area net lending/net borrowing

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



Sources: Eurostat and ECB.

property income paid to the rest of the world and further improvements in the trade balance. Thus, the euro area net lending/net borrowing² improved in the third quarter, to a deficit of 1.1% of GDP (after a deficit of 1.4% in the second quarter), on a four-quarter moving sum basis. From a sectoral standpoint, this was the result of sharply diminishing net borrowing by non-financial corporations and of the continued increase in net lending of households, which together outweighed the further increase in government net borrowing and the pronounced decrease in financial corporations' net lending (see Chart B).

From a financial account perspective, the decreased euro area net borrowing reflects the increase in euro area net outflows in currency and deposits and the decrease in net inflows in debt securities, which outweighed the increased net inflows in shares and other equity. In gross terms, the fallout from the global financial crisis continued to dampen cross-border transactions for many types of financial instruments (except debt securities, with still elevated purchases by non-residents, in particular of government securities). Most notably, the flows of interbank deposits between euro area MFIs and non-resident banks remained negative for the fourth quarter in a row, as repatriation of funds continued.

Behaviour of institutional sectors

In the third quarter of 2009, *household* nominal income decelerated further, although less than in the previous quarter and still showing a positive year-on-year growth rate. Falling compensation of employees, self-employment income and net property income earned continued to be partially compensated for by strong net social transfers received and by falling taxes paid. At the same time, real disposable income growth was still supported by favourable disinflation dynamics on a year-on-year basis, growing at +1.0% year on year in the third quarter of 2009. However, households deepened their retrenchment of real consumption initiated in mid-2008, against a background of worsening employment prospects, protracted housing market weakness, and accumulated past losses on shares (despite recouping around one third of peak-to-trough losses). As a result, households savings accelerated, with the saving rate reaching a new high of 15.5% (see Chart C). This, coupled with further falls in household non-financial investment (although less pronounced than in the past), resulted in increased financial investment and continued subdued loan growth. With regard to the portfolio structure, the return to more normal conditions was confirmed, as asset markets recovered and the preference for liquidity receded further: purchases of equity and non-money market mutual funds expanded and acquisitions of insurance technical reserves accelerated again, while acquisitions of M3 and close substitutive assets shrank (see Chart D).

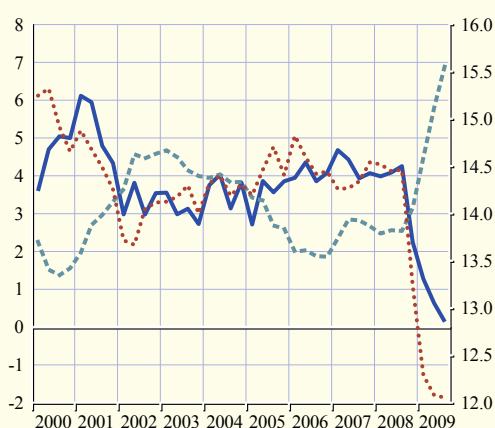
As a result of the recovery in output and continued cost cutting, the gross operating surplus of *non-financial corporations* recovered strongly in the third quarter – registering the largest quarter-on-quarter increase on record – and its annual decline halved. In addition, non-financial corporations continued benefiting from lower taxes and net interest paid and from lower net dividends distributed, helping to trigger a sharp rebound in saving (disposable income), which posted a large increase also year on year. Against the background of stabilising global demand (though at low levels of capacity utilisation) and further easing in external financing conditions, the contraction in fixed capital formation moderated in the third quarter (from -17.1% year on year to -13.7%). The rapid destocking also slowed down. As the steep pick-up in saving far exceeded the upturn in

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

Chart C Household income and consumption growth, and the saving ratio

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

- household income growth (left-hand scale)
- nominal consumption growth (left-hand scale)
- - - saving ratio (right-hand scale)

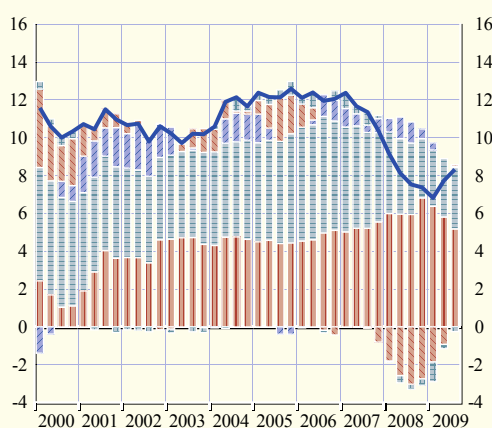


Sources: Eurostat and ECB.

Chart D Households' financial investment

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

- total assets
- currency and deposits
- insurance technical reserves
- debt securities
- equities
- other



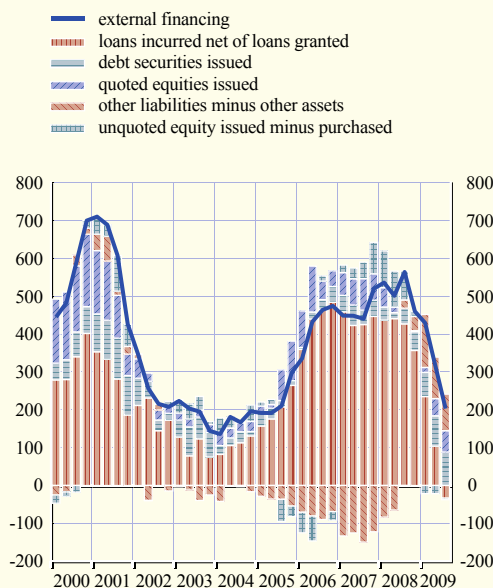
Sources: Eurostat and ECB.

capital investment, the net borrowing position of non-financial corporations improved markedly, turning even into a net lending considering solely the third quarter of 2009. The annual growth rate of external financing of non-financial corporations slowed further, while its composition changed due to pronounced substitution effects, with market financing by far exceeding MFI financing (see Chart E). Net incurrence of loans sharply decelerated to a net redemption, largely reflecting massive net redemptions in short-term loans. Firms further boosted issuance of securities, amidst falling spreads. Inter-company lending (in the form of loans granted or of trade credit), though again decelerating, remained resilient compared with nominal GDP growth, suggesting some buffering role attenuating the adverse impact of restrained bank financing. The trend towards a reduction in purchases of quoted shares came to a halt, while liquidity buffers increased overall (despite continued selling of debt securities held).

The further deterioration of *general government* accounts on a four-quarter moving sum basis largely reflects the impact of automatic stabilisers but also sizeable stimulus measures. While reaching very high deficits, there was some stabilisation in year-on-year terms, as the rapid growth in social benefits expenditure slowed and the decline in taxes and social contributions earned moderated. Debt issuance, though remaining elevated, was not as high as in the previous three quarters (partly due to seasonal factors), as Treasuries drew down their liquid assets in the third quarter and limited purchases of financial assets carried out in the context of financial rescues. The high debt securities issuance continued to be absorbed mainly by purchases by MFIs, seeking safe placements and benefiting from a profitable “carry trade”, alongside large purchases by non-residents.

Chart E NFCs' external financing by source of funds

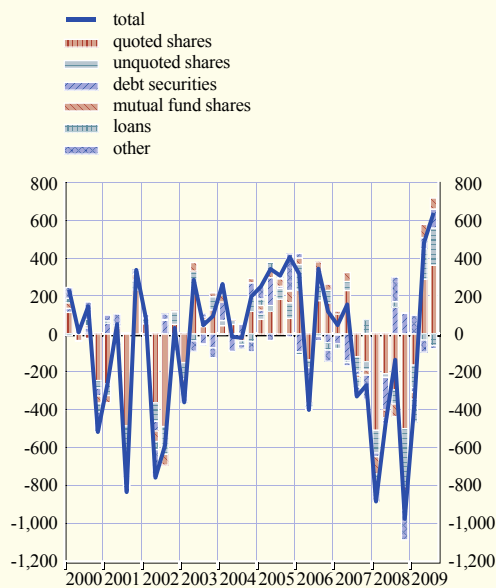
(four-quarter moving sum; EUR billions)



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

Chart F Other economic flows in financial corporations' assets

(quarterly flow; EUR billions)



Sources: Eurostat and ECB.
 Note: Other economic flows mainly relate to holding gains and losses.

The disposable income of *financial corporations* fell sharply, as the contraction in net interest earned outweighed the solid growth in gross operating surplus (the latter reflecting increased bank margins and falling compensation of employees), and as the favourable impact of cuts in net dividends earlier in the year faded away. At the same time, financial corporations benefited from substantial holding gains in recent quarters on equity as well as on debt securities. Gains on government securities held compensated for the large write-downs initially incurred on “toxic assets” (see Chart F).³ Despite ongoing pressures to deleverage, additions to financial corporations' balance sheets remained positive though subdued. They reached an average of €200 billion per quarter since the end of 2008, excluding interbank transactions, as against up to €1 trillion per quarter during the preceding leverage boom. However, the shift towards safer assets continued by acquiring government securities on a large scale, diminishing the exposure to cross-border assets and limiting loan origination. This reinforced role of market instruments amongst the assets of financial corporations may be part of a more general disintermediation pattern across sectors as economic agents adapted their funding and portfolio behaviour in the wake of the financial turmoil.

Financial markets

In the third quarter of 2009 governments remained the main net issuers of debt securities. Non-financial corporations continued raising substantial funds on this market by way of issuance as well as disposal of debt securities held. MFIs were large net purchasers of debt securities

³ It should be noted that, in the case of loans, which are valued at nominal value in the euro area accounts, impairment only has an impact on the financial wealth of creditors at the time when they are actually written off, i.e. with a considerable delay.

(of government notably) while net issuance remained weak. There was a deceleration of issuance by other financial intermediaries (OFIs), though it still remained at an elevated level, mostly through securities directly purchased by sponsoring MFIs. The rest of the world slowed its sizeable net buying, while purchases by households and institutional investors accelerated.

On the mutual funds market, net issuance of non-money market mutual fund shares accelerated on the back of resumed appetite of households for riskier and longer-term assets.

On the quoted shares market, net issuance remained strong, in the context of capital enhancement needs of MFIs and the move of non-financial corporations towards non-bank financing. Non-financial corporations kept purchasing, as cash constraints were less binding. Investment funds (included in the OFI sector) became prominent buyers, while MFIs resumed selling.

On the loan market, non-financial corporations redeemed strongly, in particular in the short-term segment, replacing loans with other liability classes, while household borrowing remained subdued in a context of low expenditure.

Balance sheet dynamics

A continued rebound in global equity markets attenuated the negative impact of previous losses on the net financial wealth of households, limiting the cumulated loss incurred in the four quarters up to the third quarter of 2009 (although the cumulated loss from the mid-2007 peak remained considerable). Similarly, the equity-to-assets ratio of financial corporations, measured at market value, continued its recovery from the low levels of March 2009, reflecting the increase in stock prices of financial corporations and, to a lesser extent, renewed equity issuance.