Box 7

INTEGRATED EURO AREA ACCOUNTS FOR THE FOURTH QUARTER OF 2009[1]

The integrated euro area accounts up to the fourth quarter of 2009 released on 30 April 2010 offer comprehensive and consistent information on the income, spending, financing and portfolio decisions of institutional sectors of the euro area. These accounts show the economy continuing to rebound from the trough reached in the second quarter of 2009, further signs of normalisation, as well as a return of risk appetite in favour of market instruments.

Euro area income and net lending/net borrowing

The further rebound in nominal disposable income of the euro area, to an annual rate of change of -0.5% in the fourth quarter of 2009 from -2.7% in the third quarter, benefited all sectors. Household income growth picked up, income of non-financial corporations (NFCs) continued to expand rapidly, and the decline, in annual terms, of government income moderated (Chart A).

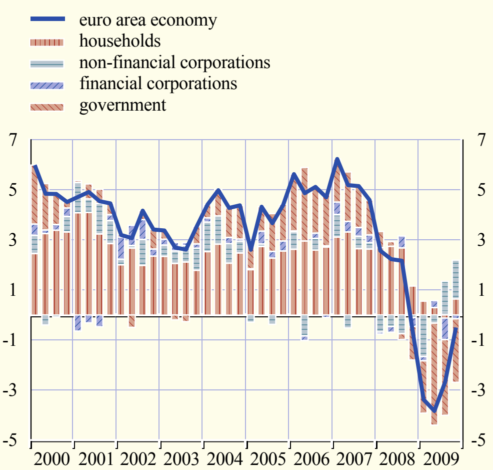
In this context, the annual decline in euro area saving further moderated (to -5.8% in the fourth quarter of 2009), on the back of dynamic NFC retained earnings and less rapid annual contractions in government saving (government dissaving remaining stable at a high level over the last three quarters). In parallel, the year-on-year decline in gross capital formation also moderated (to -13.9% in the fourth quarter from -19% in the second quarter).

With a less pronounced decline in saving than in capital formation, euro area net borrowing fell again in the fourth quarter of 2009 (to a deficit of 0.8% of GDP, on a four-quarter moving sum basis). From a sectoral viewpoint, this improvement reflects the very rapid reduction

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

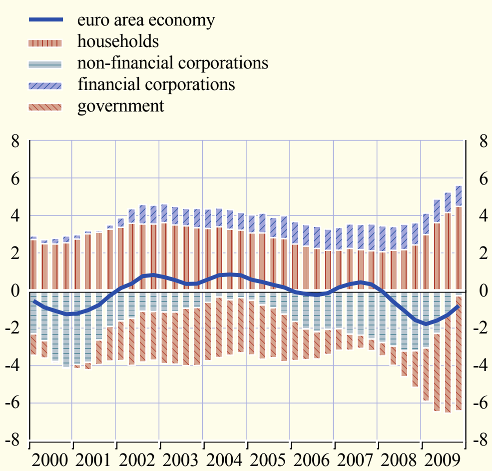
(annual percentage changes; percentage point contributions)



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.

in net borrowing of NFCs (on a four-quarter moving sum basis, with even surpluses in the second half of 2009, after record financial deficits in mid-2008) which, together with a further increase in households' net lending (financial savings), absorbed the additional deterioration in government deficits on a four-quarter moving sum basis.[2] The latter reached a record 6.1% of GDP for the year 2009 as a whole (with some stabilisation noted since the second quarter of 2009 on a seasonally adjusted basis; Chart B).

The mirror image of these developments can be seen in the external accounts, with an improving current account balance. The fallout from the financial crisis continued to dampen "gross" cross-border transactions for many types of financial instruments, although a shift towards more risky equity instruments can be observed. The flows of interbank deposits between euro area MFIs and foreign banks remained negative for the fifth quarter in a row, as repatriation of funds continued.

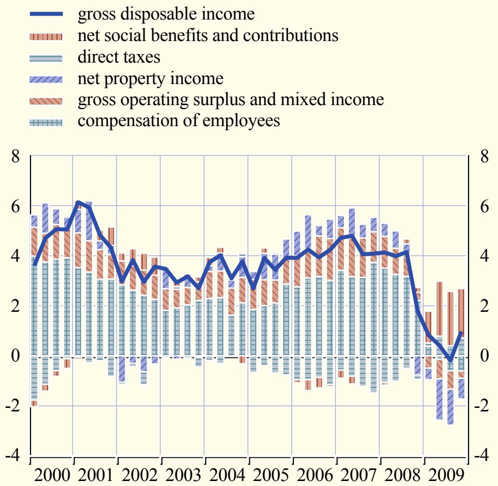
Behaviour of institutional sectors

In the fourth quarter of 2009, *household* nominal income growth turned positive, after having been in negative territory in the third quarter. This recovery was largely driven by a marked slowdown in the rate of contraction of dividends as well as of mixed income earned, while social benefits received net of social contributions and taxes paid continued to strongly support household income growth. Compensation of employees remained subdued, on the back of falling employment and slowing wages (Chart C). The household savings rate fell marginally in the fourth quarter of 2009 on a seasonally adjusted basis (to 15.1%) by 0.1 percentage point, after a

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 nominal gross disposable income

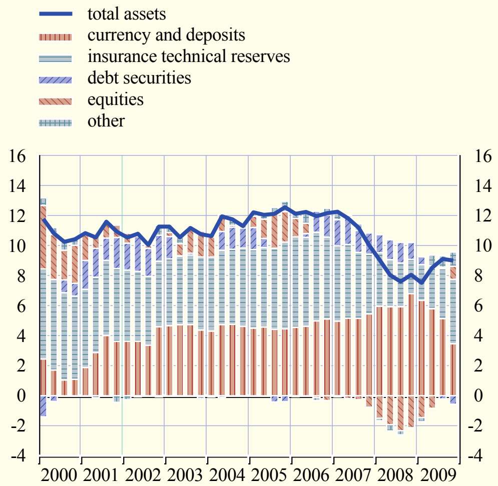
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Household financial investment

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



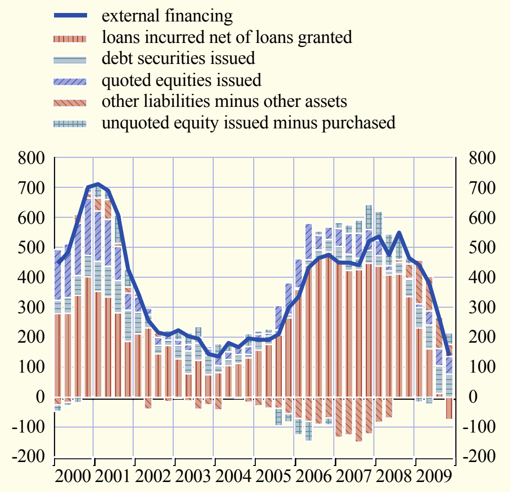
Sources: Eurostat and ECB.

fall of 0.5 percentage point in the third quarter, in conjunction with a further increase in financial wealth driven by equity markets and notwithstanding an adverse outlook for employment and public finances. Household net lending stabilised in the fourth quarter (while still expanding on a year-on-year basis), as investment bottomed out. Loan growth stabilised at subdued levels. On the asset side, patterns of portfolio allocation point to liquidity preference receding further, a renewed search for yields and a return of risk appetite. In particular, purchases of equity, notably non-money market mutual funds, expanded to the detriment of low-yielding deposits (Chart D).

The gross operating surplus of *non-financial corporations* continued to recover in the fourth quarter, and its annual decline moderated rapidly to -1.7% (from -14.2% in the second quarter of 2009). The ratio of gross operating surplus to value added (a measure of profit margins) rose again, on a seasonally adjusted basis, to 37.9% in the fourth quarter, up 0.4 percentage point, after reaching a trough in the first quarter of 2009. NFCs also benefited again from rapidly falling net interest paid, while taxes and net dividends distributed stabilised in the fourth quarter at very low levels. The sharp rebound in saving (and disposable income) observed in the third quarter was thus confirmed, resulting in a large year-on-year increase to the fourth quarter. At the same time, the annual contraction of NFC fixed capital formation moderated further in the fourth quarter (to -9.9%). Destocking continued in the fourth quarter at a still rapid pace. In total, with stronger saving than capital investment, the net borrowing position of NFCs continued improving, having turned into a net lending position, on a quarterly basis, in the third quarter of 2009. The annual growth rate of external financing of NFCs slowed further, with still pronounced substitution effects, as market financing (debt securities and quoted shares) more than offset net redemptions in MFI loans: +135 billion euro versus -105 billion euro respectively for 2009 as a whole (Chart E). Growth in trade credits and loans granted by NFCs (mostly "intra-sector" funding) continued to decelerate,

Chart E NFC external financing by source of funds

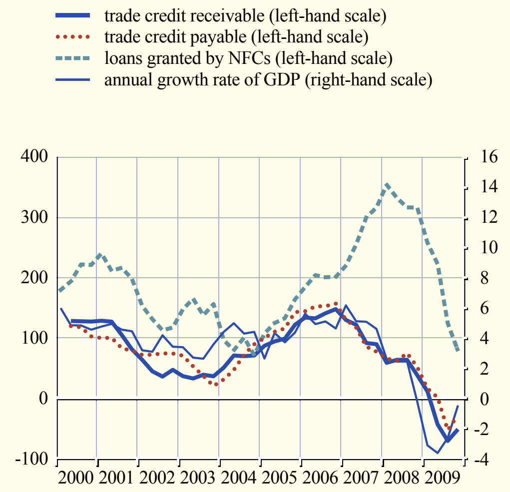
(four-quarter moving sum; EUR billions)



Sources: Eurostat and 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 NFC loans granted and trade credit receivable and payable

(four-quarter moving sum in EUR billions; annual percentage changes)



Sources: Eurostat and ECB.
Note: Trade credit receivable and payable are estimated by the ECB based on partial information.

despite the pick-up in nominal GDP growth, which suggests a normalisation in the buffering role played during the crisis so far, in view of improving cash flow positions of businesses and some relaxation in bank financing (Chart F). Against this background, NFCs substantially replenished their liquidity buffers (deposits but also debt securities).

While *general government* accounts deteriorated further on a four-quarter moving sum basis, the improvement in year-on-year change terms points to some stabilisation of the deficit close to a trough, possibly reached in the second quarter of 2009. This stabilisation likely reflects the ongoing impact of automatic stabilisers in a moderately recovering economy as well as some unwinding of stimulus measures. Less marked annual contractions in most revenue items are reported, except for taxes and social contributions paid by households. Debt issuance, though still high, was not as massive in the last two quarters as in the previous nine months, when governments had to fund substantial purchases of financial assets in the context of financial rescues. The still high government debt securities issuance continued to be largely absorbed by MFIs and non-residents.

The disposable income of *financial corporations* fell year on year, though less rapidly than before. The ongoing contraction in net interest earned (which outweighs the solid growth in gross operating surplus stemming from increased bank margins and falling compensation of employees) was mitigated in this quarter by more pronounced cutbacks in net dividends distributed. In addition to sizeable net retained earnings of around €100 billion in 2009, financial corporations benefited from substantial holding gains in recent quarters (Chart G). Gains on equity and debt securities held compensated for the large write-downs initially incurred on "toxic" assets, and price gains for a number of structured products started to be even more frequently reported.[3] Despite pressure to deleverage, additions to their balance sheets (excluding interbank deposits) remained positive, amounting to an average of €200 billion per quarter, after a trough in the fourth quarter of 2008, compared with up to €1 trillion during the preceding leverage boom. The shift towards safer assets continued, favouring government securities, diminishing cross-border exposures and limiting loans. The reinforced role of market instruments amongst the assets of financial corporations points to some signs of disintermediation in the wake of the crisis. Similarly, NFCs are expanding debt issuance on the markets, and households are favouring again market instruments (in particular via collective investment vehicles).

Financial markets

On the *debt securities* market, the considerable expansion of net transactions in debt securities in the fourth quarter of 2008 and the first quarter of 2009 receded further in the last quarter of 2009, although government issuance remained elevated. NFCs resumed purchases. The net buyer position of other financial intermediaries (OFIs) reflects heavy purchases by mutual funds (on the back of a return of investors searching for yield), compensating for still large issuance by special-purpose vehicles, notably in the context of ad hoc securitisation (for use as collateral in ECB refinancing operations). MFIs resumed issuance and at the same time disposed of debt securities held. The rest of the world remains a net buyer, with large purchases by non-residents. On the *mutual funds* market, issuance of non-money market mutual fund shares accelerated again on the back of household appetite for riskier and longer-

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, and not at the time they are written down.

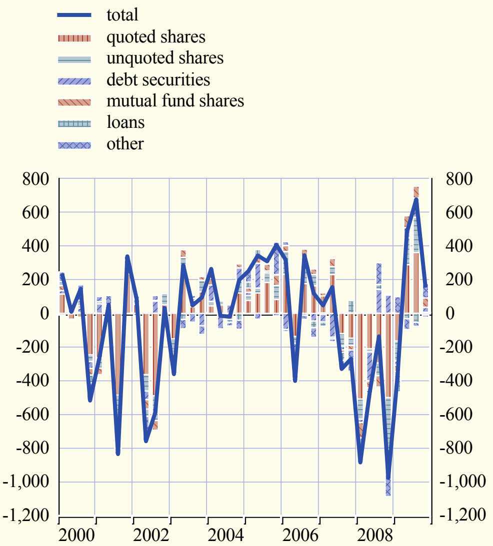
term assets. On the *quoted shares* market, net issuance remained strong, in the context of capital enhancement needs of MFIs and of a progressive move of NFCs towards non-bank financing. NFCs were net sellers of equity held, and investment funds (in the OFI sector) were prominent buyers. On the *loan market*, NFCs continued redeeming MFI loans, in particular in the short-term segment, replacing them with other liability classes, while growth in household loan borrowing bottomed out moderately.

Balance sheet dynamics

In the fourth quarter of 2009, the annual change in household net worth turned positive, after two years of negative readings. Although the influence of net saving (9% of income) is still largely neutralised by holding losses, the latter now concern mostly real estate, whereas equity has been generating holding gains, on the back of a stock market rally (Chart H). The increase in market prices is also boosting the balance sheets of banks, which are heavy in equity, and gains generated far exceed write-offs on loans (Chart G).

Chart G Holding gains and losses on financial corporations' assets

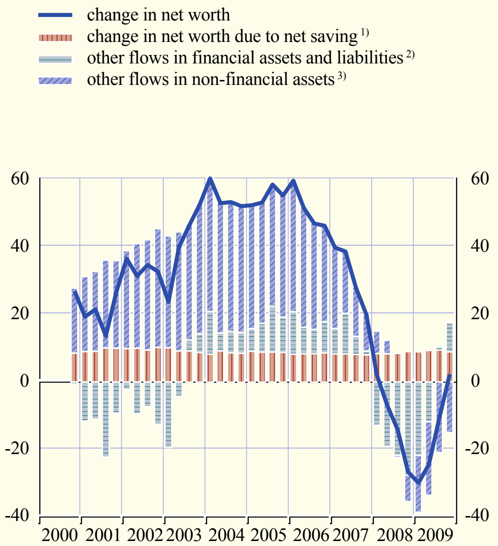
(quarterly flow; EUR billions)



Sources: Eurostat and ECB.
Note: "Total" refers to "Other economic flows", which mainly relate to holding gains and losses (including loan write-offs).

Chart H Change in net worth of households

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



Sources: Eurostat and ECB.
Notes: Data on non-financial assets are estimates by the ECB.
1) This item comprises net saving, net capital transfers received, and the discrepancy between the non-financial and the financial accounts.
2) Mainly holding gains and losses on shares and other equity.
3) Mainly holding gains and losses on real estate and land.