

Box 4

INTEGRATED EURO AREA ACCOUNTS FOR THE THIRD QUARTER OF 2010¹

The integrated euro area accounts offer comprehensive and consistent information on the income, spending, financing and portfolio decisions of the institutional sectors of the euro area. The data released on 28 January 2011, covering data up to the third quarter of 2010, show further signs of normalisation in the euro area as the recovery proceeds. The growth of households' disposable income was driven mainly by the primary distribution of value added, while the contribution of government redistribution via net transfers and direct taxes was negative. The savings ratio of households decreased further, while their net worth continued to grow in annual terms (on the back of increasing prices of both financial and non-financial assets). Non-financial corporations (NFCs) continued to move further towards a net borrowing position, after a period marked by an unusual net lending position. Real flows remained broadly subdued (households' income decreased in real terms), while agents continued to adjust their balance sheets, in particular in the NFC sector. Patterns of disintermediation in favour of market instruments were still evident across sectors, while risk appetite rebounded as the sovereign debt tensions eased somewhat.

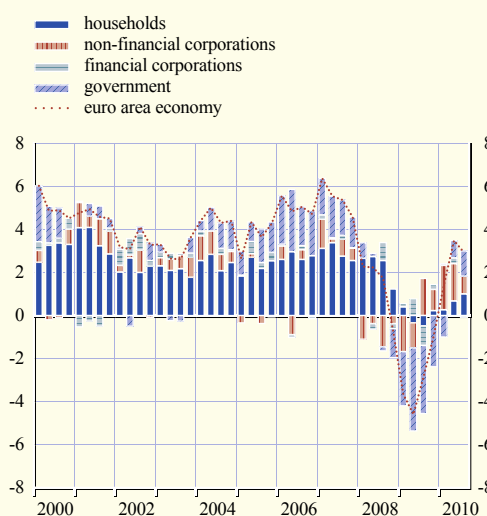
Euro area income and net lending/net borrowing

The annual growth rate of nominal disposable income in the euro area slowed down slightly in the third quarter of 2010, to 2.9% (after 3.5% in the previous quarter – see Chart A). This growth benefited all sectors in the economy except for financial institutions whose income decreased. NFCs' income growth was again robust at 6.9%, albeit less than in the second quarter of 2010, as the growth of value added slowed down, tax expenses increased and the distribution of profits accelerated. Government income growth picked up once more, as taxes on production and imports rose markedly. Households' income growth accelerated as well, via an increase in both dividend income and, to a lesser extent, compensation of employees, while direct taxes put a damper on income growth for the first time in two years. Households' real income remained subdued and continued to contract as consumer price inflation picked up.

For the second consecutive quarter, the expansion in income translated into an increase in gross saving in the euro area, reflecting – in particular – less negative government savings and a continuing growth in NFCs' retained earnings in the context of a persistent building

Chart A Euro area gross disposable income and sectoral contributions

(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

¹ Detailed data can be found on the ECB's website at <http://sdw.ecb.europa.eu>.

up of liquidity buffers. In spite of the increase in households' income, their savings again fell as consumption continued to grow in real terms, thereby outgrowing income. The household savings ratio decreased to 13.8%, seasonally adjusted, approaching pre-crisis levels.

Gross fixed capital formation picked up further to a year-on-year growth rate of 1.7%, as growth for both households and financial institutions turned positive for the first time in several quarters. At the same time, given that the pace of NFCs' cutting back of inventories decreased, total capital formation increased by 7.2% in comparison with the same quarter of last year.

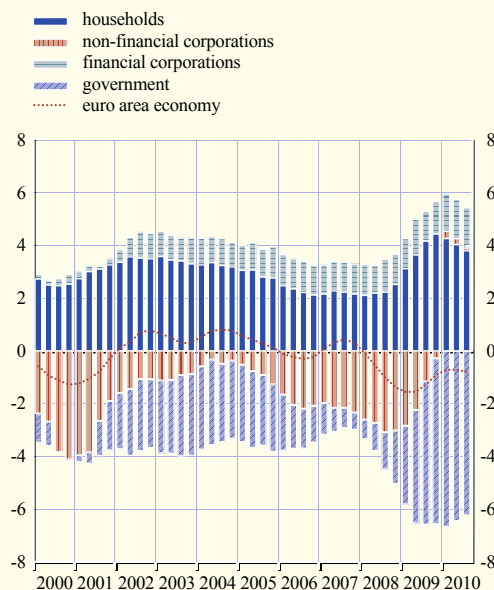
The euro area's current account deficit increased for the first time in a year and a half (to 0.8% of GDP, calculated as four-quarter moving sums – see Chart B), since capital formation outgrew savings. The increase in the deficit was driven mainly by the continuing decline in the household savings rate, while it was mitigated by the improving government accounts. NFCs maintained their unusual net lending position (albeit at a lower level than in previous quarters), i.e. they continued, on balance, to provide financing to other sectors. As in previous quarters, the funding of the current account deficit continued to be dominated by net inflows in debt securities (on a four quarter sum basis), although non-residents' purchases of euro area debt securities came to an abrupt stop in the third quarter.

Behaviour of institutional sectors

The year-on-year growth of households' nominal gross disposable income increased to 1.5% (after 0.9% in the previous quarter) on account of higher net property income, in particular rising dividend payments (see Chart C). While compensation of employees remained the largest contributor to year-on-year income growth, it contributed only marginally to the additional growth. The effects of the automatic fiscal stabilisers

Chart B Euro area net lending/net borrowing

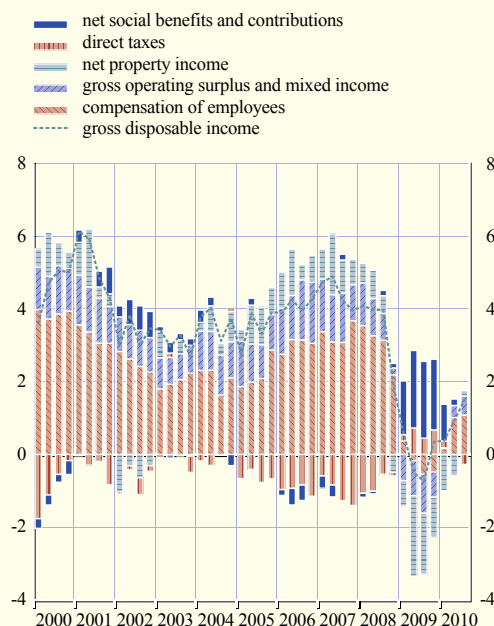
(percentages of GDP; four-quarter moving sum)



Sources: Eurostat and ECB.

Chart C Households' nominal gross disposable income

(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

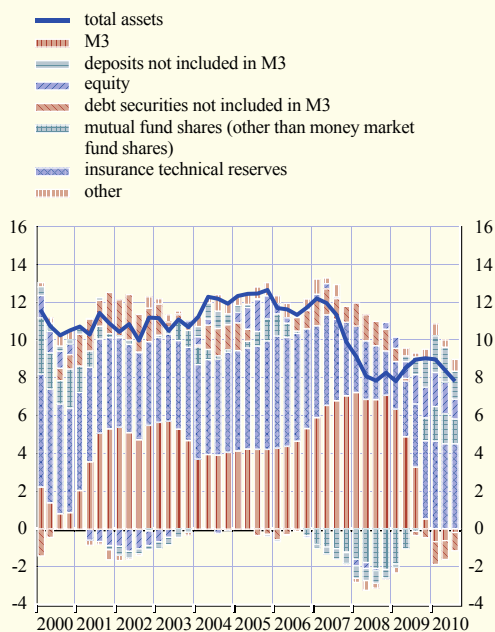
reversed, as direct taxes made a negative contribution for the first time since 2008 and the growth of income from government transfers came to a halt. Thus, income growth originated directly from entrepreneurial activities (mainly dividend payments).

As in the previous quarter, the still subdued increase in households' nominal income was smaller than the increase in consumer prices, leading to a further contraction of real income. Similarly, a more robust growth of consumption (2.8%) and the recovery in non-financial investment (with the second successive quarter of positive annual growth after two years of decline) led to a further drop in their net lending position, which is now approaching pre-crisis levels. This was reflected in a continued expansion of loan financing and a decline in financial investment measured as a percentage of gross disposable income (by 0.6 percentage points – see Chart D), pointing to some portfolio shift back towards housing equity. Overall, the sizeable portfolio reallocations towards non-monetary assets, which have been recorded since the end of 2008, continued – albeit at a slower pace – with insurance technical reserves accounting for more than half the financial investment.

The year-on-year growth in the operating surplus of NFCs moderated to 4.7% in the third quarter of 2010 down from 8.3% in the second quarter, owing mainly to increased tax payments. At the same time, non-interest property income paid (mainly dividend payments) increased for the first time since 2008. The still strong increase in non-financial investment (fuelled by fixed capital formation, which grew for the second quarter in a row to stand at 2.9%, after having declined continuously in previous quarters), resulted in an ongoing trend towards a return to a net borrowing position, although four-quarter moving sums still show a net lending position (see Chart E). In this context, external financing

Chart D Households' financial investment

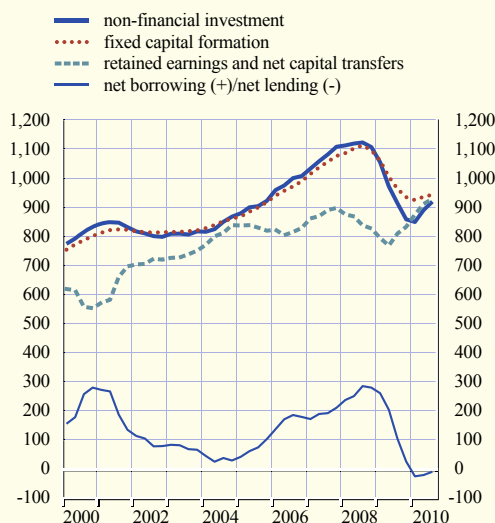
(four-quarter moving sums; percentages of gross disposable income)



Sources: Eurostat and ECB.

Chart E NFCs' saving, non-financial investment (including fixed capital formation) and net borrowing

(four-quarter moving sums; EUR billions)



Sources: Eurostat and ECB.

(total financial liabilities) continued to pick up, growing at 2.1%, year on year, in the third quarter of 2010, after having rebounded from two years of continued decline at the beginning of the year. Substitution effects were still being observed, as market financing (debt securities and quoted shares) balanced net redemptions of MFI loans (see chart F).

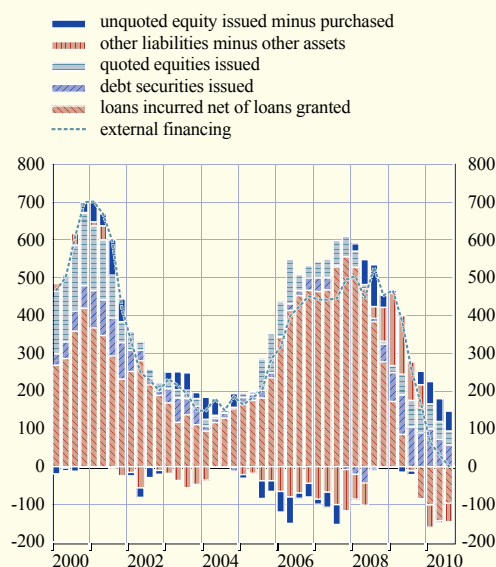
The leverage ratios, although still at historically high levels, continued along the path of decline from the peaks reached at the beginning of 2009: the debt-to-assets ratio of NFCs dropped to 26.1% in the third quarter of 2010. With respect to the associated cash-flow vulnerability, the ratio of net interest payments to gross value-added declined further to 2.4%. This downwards dynamic was extended to the debt-to-gross value-added ratio, which declined for the second successive quarter.

The general government sectors' net borrowing decreased to 6.2% of GDP (four-quarter moving sum), down from 6.5% of GDP in the previous quarter. Developments in the second and third quarters of 2010 indicate a reversal of the negative trend that began in the first quarter of 2008, when net borrowing by the general government had only amounted to 0.7% of GDP. This improvement reflects slightly lower gross government investment (2.6% of GDP, down from 2.7% of GDP in the previous quarter) and lower gross dissavings, which fell from 3.8% of GDP in the second quarter to 3.6% of GDP in the third. Euro area general government gross disposable income rose by 6.5% on an annual basis, up from 4.0% in the previous quarter. Taxes on production and imports were the main contributors to this increase. These developments reflected mainly the operation of automatic stabilisers in a modestly recovering economy. The annual growth rate of financial investment increased moderately to 0.7% (four-quarter moving sum), following the contraction recorded in the first and second quarters (by 1.5% and 0.5% respectively). That points to a certain degree of normalisation after financial investment reached a historical high in the context of support measures for the financial sector in the first quarter of 2009.

The gross entrepreneurial income of financial institutions grew robustly in the third quarter (3.3%, year on year) as the institutions continued to benefit from the still steep yield curve. The annual growth rate of financial investment (transactions over stocks) increased by 0.4 percentage points to 2.9%, mainly on account of a recovery in MFI loans granted (in particular to non-financial corporations, although the annual growth rates were still negative), reflecting a progressive return towards a more traditional bank business model. Similarly, the increase in liabilities (2.6%) was mainly due to increasing financing through deposits. Moreover, financing through liabilities of institutional investors (insurance technical reserves of insurance corporations and

Chart F NFCs' external financing by source of funds

(four-quarter moving sums; EUR billions)



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

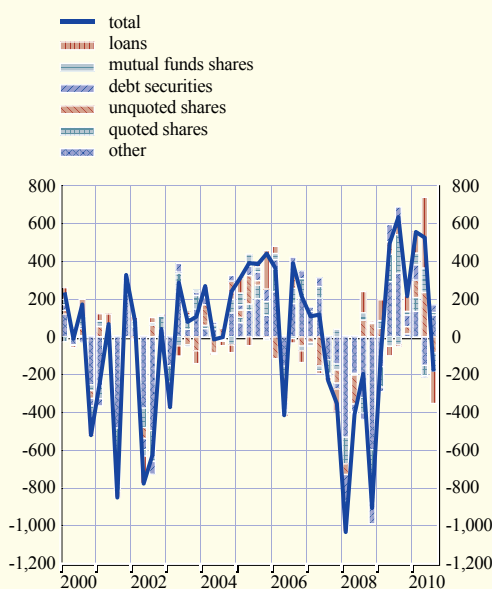
pension funds (ICPFs) and mutual fund shares issued by other financial intermediaries (OFIs)) continued to be the main contributor to total financing, although its share decreased slightly. All in all, the disintermediation trend that favours financing outside the bank channel continues to be apparent.

Financial markets

Net issuance of government debt securities, which dominates the bond market, was less dynamic in the third quarter. NFCs moderated their issuance as well (while continuing to sell some of their debt securities held). The rest of the world turned into a net seller of debt securities as non-residents discontinued their formerly large purchases. Households began to sell such securities again. Insurers stepped up their purchases and MFIs remained net buyers as well, although this was due primarily to their continued redemptions of liabilities. OFIs returned to being net buyers, a position reflecting a balance between purchases by mutual funds and operations such as issuance through special-purpose vehicles (for instance, in the context of ad hoc securitisation).

Chart G Holding gains and losses on financial corporations' assets

(quarterly flow; EUR billions)

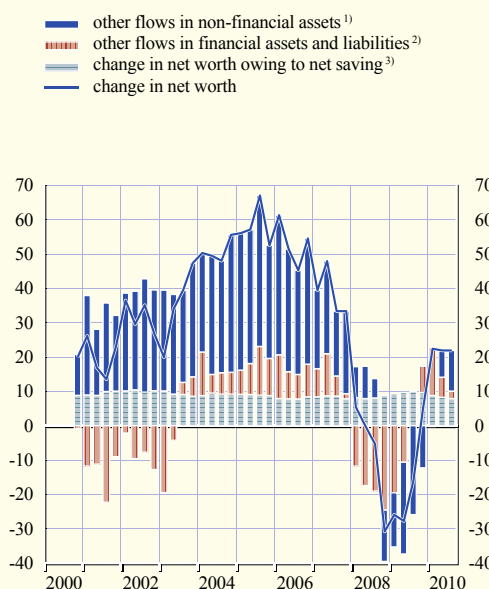


Sources: Eurostat and ECB.

Note: This chart shows other economic flows, which mainly refer to holding gains and losses (realised or unrealised) on assets that are valued at market value in the integrated euro area accounts (quoted, unquoted and mutual fund shares and debt securities). For the rest of the asset classes (notably loans), which are valued at nominal value, it shows the changes in balance sheets that are due to exchange rate variations and the writing-off of bad assets from the balance sheets of the creditor and the debtor upon recognition by the former that the cash flows associated with the asset can no longer be collected.

Chart H Change in net worth of households

(four-quarter moving sums; percentages of gross disposable income)



Sources: Eurostat and ECB.

1) Mainly holding gains and losses on real estate and land.
2) Mainly holding gains and losses on shares and other equity.
3) This item comprises net saving, net capital transfers received and the discrepancy between the non-financial and the financial accounts.

Balance sheet dynamics

The portfolios of debt securities held by financial institutions had increased sharply in value in the second quarter of 2010, on account of the high weight of safe-haven securities that benefited from flight-to-quality flows in the context of the sovereign debt crisis. This was partially reversed in the third quarter, as tensions eased (Chart G). Equity increased in value on the back of the stock market rally in that quarter.

In the third quarter of 2010, the annual change in households' net worth was broadly unchanged at 21.9% of their annual income. Aside from the positive influence of net saving (7.9% of income), households benefited from holding gains (14.1% of their income) on equity values, due to the aforementioned strong market rally and a rebound in housing wealth. (Chart H).