

## Box 4

**INTEGRATED EURO AREA ACCOUNTS FOR THE THIRD QUARTER OF 2011<sup>1</sup>**

The integrated euro area accounts released on 30 January 2012, covering data up to the third quarter of 2011, offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. The progressive sectoral rebalancing of financial deficits/surpluses observed during the phase of economic recovery resumed in the third quarter: the household saving ratio, after stabilising in previous quarters, fell again to pre-crisis lows; the strong reduction in government deficits resumed; and non-financial corporations (NFCs) again recorded a net borrowing position, although this levelled off somewhat. At the same time, large holding losses on equity holdings on the back of renewed financial market turbulence in the quarter contributed to increasing the leverage ratio of NFCs, to dampening households' net wealth growth and to reversing the improvement in financial corporations' capital ratios measured at market value.

**Euro area income and net lending/net borrowing**

Annual growth in euro area nominal gross disposable income edged down to 3.0% in the third quarter of 2011, reflecting the slowdown in economic activity (see Chart A). Euro area income nonetheless expanded faster than total consumption (which included low government consumption growth of below 1% year on year), resulting in continued solid growth in euro area gross saving (6.6% year on year) in the third quarter of 2011. This reflected strongly reduced dissaving by governments and increased saving by financial corporations, but lower saving by households and NFCs. Euro area fixed capital formation growth edged down to 3.1% in the third quarter of 2011, mostly as a result of a decline in government investment, while both NFC and household investment growth increased somewhat. In addition, the levelling off in restocking caused gross capital formation to grow at a slower pace in the third quarter of 2011 (3.6% year on year) than at the beginning of the year.

As euro area gross capital formation grew at a slower pace than saving in the third quarter of 2011, the euro area net borrowing position declined again, to close to balance on a seasonally

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

**Chart A Gross disposable income in the euro area – contribution by sector**

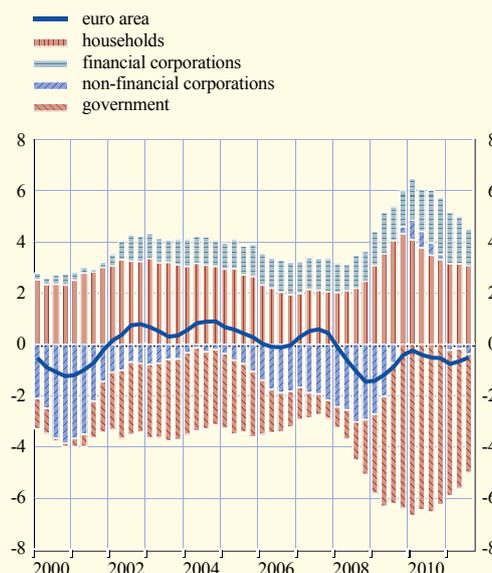
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

**Chart B Net lending/net borrowing of the euro area**

(percentages of GDP; four-quarter moving sums)



Sources: Eurostat and ECB.

adjusted basis (and to a deficit of 0.5% of GDP on a four-quarter sum basis). This development mirrors the decline in the current account deficit, which reflects improved net exports of goods and services. From a sectoral viewpoint, it mostly reflects the resumption of the reduction in government deficits (to 4.6% of GDP in the third quarter of 2011, on a four-quarter sum basis, from a peak of 6.7% in the first quarter of 2010), a small reduction in NFCs' net borrowing and a small increase in financial corporations' net lending (all on a seasonally adjusted basis). By contrast, household net lending contracted somewhat (see Chart B).<sup>2</sup> On the financing side, cross-border transactions continued to expand (by €100-200 billion per quarter in recent quarters), but reduced gross inflows in debt securities and some disposals of equity held abroad in the course of the third quarter of 2011 suggest some return of investors' home bias.

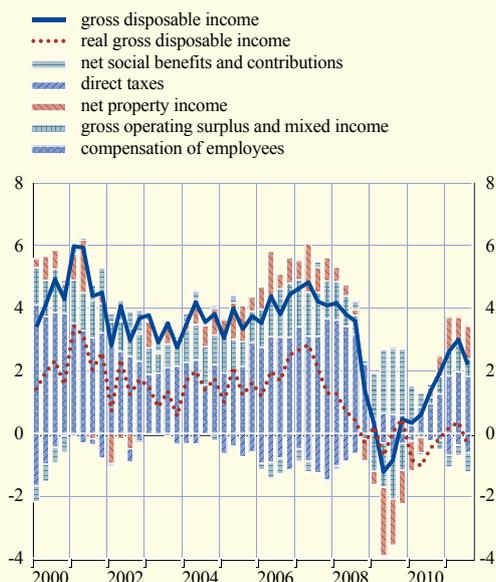
### Behaviour of institutional sectors

*Households'* nominal income growth fell to 2.2% year on year in the third quarter of 2011 owing to the increasingly adverse impact of the fiscal drag (tax payments and net social transfers) and to lower growth in gross operating surplus and mixed income (see Chart C). Growth in wages and salaries also levelled off, while net property income earned supported household income growth. In real terms, household income resumed its decline (-0.4% year on year), after a brief interruption in the first half of the year, notably owing to high commodity-price-driven inflation. With private consumption remaining more robust than income, households again tapped their stock of precautionary savings. As a result the saving ratio fell again, on a seasonally adjusted

<sup>2</sup> The net lending/net borrowing of a sector is the balance of its capital account, which measures the excess of saving and net capital transfers received over capital investments (net lending), or vice versa (net borrowing). It is also the balance of the financial accounts, which measures the difference between transactions in financial assets and transactions in liabilities.

Chart C Households' nominal gross disposable income

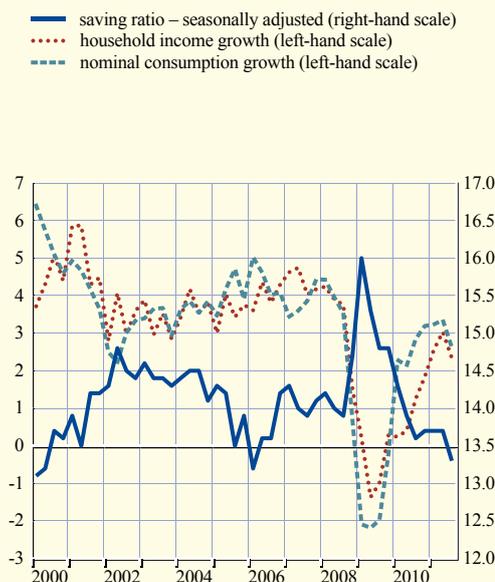
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' income, consumption and saving ratio

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



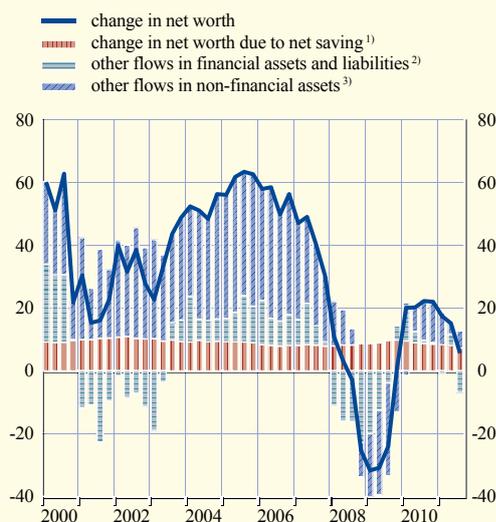
Sources: Eurostat and ECB.

basis, to a pre-crisis low (13.3%, see Chart D). Combined with a slight increase in investment, this drove the household net lending position down. In this context, as growth in financing was stable at low levels, households further reduced financial asset accumulation, shifting their portfolios towards less risky deposits and debt securities. Holding losses incurred by households on their equity portfolios reduced the year-on-year growth of their net wealth (see Chart E).

The growth in the gross operating surplus of *NFCs* slowed again markedly in the third quarter of 2011, as value added growth decreased, although this was partly compensated by some moderation in annual wage growth from its second quarter peak of +3.7% year on year. Also, *NFCs* stepped up dividend distribution (net of dividends earned) and paid higher corporate tax. As a result, *NFC* savings (i.e. their retained earnings) registered an abrupt decrease in the growth rate, to -1.3% year on year, though remaining at still high nominal levels (see Chart F). With gradually increasing fixed capital investment but moderating restocking, *NFC* net borrowing increased (on a four-quarter sum basis), although it remained moderate. This contrasts with the fragility, prior to the bankruptcy of Lehman Brothers, of an overextended *NFC* sector, which at the time showed a very large net borrowing position. The present, cautiously expansionary posture of *NFCs* is reflected in a slight acceleration in financing on a consolidated basis, while *NFCs* stepped up their acquisitions of equity in the third quarter of 2011 and further built up their ample liquidity buffers (€2.6 trillion). The disintermediation in *NFC* external financing triggered after the bankruptcy of Lehman Brothers moderated further, as growth in MFI lending accelerated somewhat (to 1.9% year on year), while growth in debt securities issuance and in intra-sector lending (trade credit and intra-group credit) were broadly stable, below the robust levels seen in 2009-10. At the same time, the gradual reduction

**Chart E Change in the net worth of households**

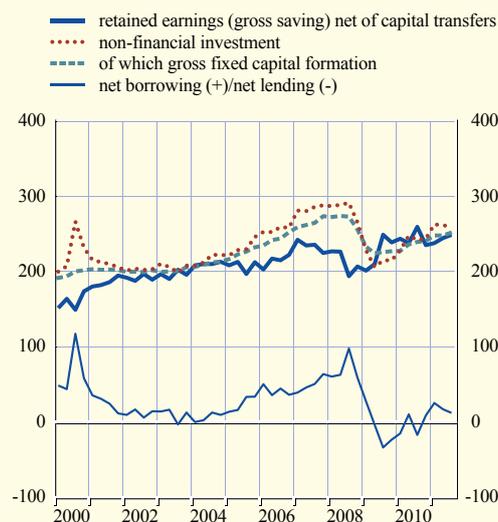
(four-quarter moving sums; percentages of gross disposable income)



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.

**Chart F Non-financial corporations' saving, capital investment and net lending(-)/net borrowing(+)**

(EUR billions, seasonally adjusted)



Sources: Eurostat and ECB.  
Note: Seasonal adjustment by the ECB.

in leverage observed since the first quarter of 2009 was interrupted, with a second quarterly increase, as the result of the adverse impact of holding losses on equity held.

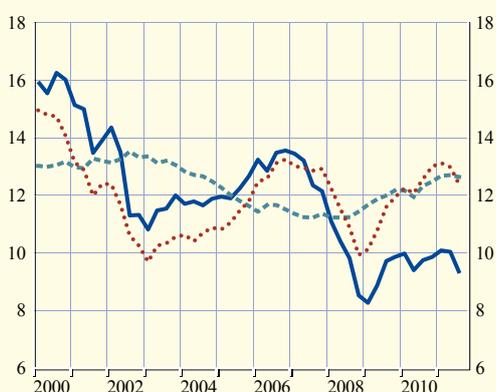
In the third quarter of 2011 the fairly rapid reduction in *government* deficits since the beginning of 2010 (on a seasonally adjusted basis) resumed, after an interruption in the second quarter, as a temporary weakness in tax revenue reversed. Year-on-year growth in total expenditure remained fairly low at close to 1% (excluding one-off transfers), reflecting the impact of sizeable consolidation measures (including close to zero annual growth in compensation of employees), despite significant increases in interest payments. Debt issuance slowed on a quarterly basis (albeit remaining elevated on a four-quarter sum basis) and was largely absorbed by purchases under the Securities Markets Programme as banks and non-residents reduced their holdings.

The disposable income of *financial corporations* increased in the third quarter of 2011 as a result of a larger increase in dividends earned than in dividends paid, while value added plus net interest earned continued to grow. Despite sizeable net retained earnings (€35 billion per quarter in recent quarters), financial corporations' net assets at market value (a euro area accounts measure of capital ratio) fell markedly as a result of the pronounced holding losses on equity portfolios, although it remained significantly above the market's valuation of their equity (see Chart G). Chart H shows that financial corporations suffered large holding losses on, mostly, their portfolios of equity assets held (quoted shares, unquoted shares and mutual funds). On other instruments (deposits, loans and debt securities held), by contrast, holding gains were recorded, stemming in part from the appreciation of assets denominated in foreign currencies. In addition, the holding losses on debt securities issued by sovereigns under stress (all recorded at market value in the

**Chart G Capital ratios of financial institutions excluding mutual funds**

(percentage of total assets)

- equity to assets
- ... capital to assets
- - - notional capital to assets



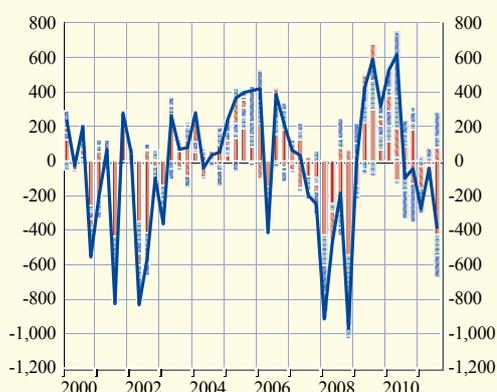
Source: ECB.

Note: "Equity" comprises here shares and other equity other than mutual fund shares. "Capital" is defined as the difference between financial assets and liabilities other than equity. All assets and liabilities are valued at market value. The "notional capital to assets" ratio is calculated on the basis of transactions in capital and assets, i.e. excluding changes in prices of assets and liabilities.

**Chart H Holding gains and losses in financial corporations' assets**

(quarterly flows; EUR billions)

- total
- quoted shares
- unquoted shares
- mutual fund shares
- debt securities
- loans
- other



Sources: Eurostat and ECB.

Note: Total refers to "other economic flows", which mainly relate to (realised or unrealised) holding gains and losses (including loan write-offs).

euro area accounts, whether part of trading or investment books) were more than compensated by gains on other debt securities held, including those issued by other euro area governments that benefited from safe haven flows.

### Balance sheet dynamics

In the third quarter of 2011 the annual growth in households' net worth slowed noticeably to 5.6% of income (from a peak of 22% in the fourth quarter of 2010). While there was a positive, but somewhat decreasing, influence from net saving (7.2% of income), households suffered overall holding losses (1.6% of income), mainly on their equity portfolios. Holding gains, albeit subdued, were again recorded on non-financial assets (housing) (see Chart E).

The fall in equity prices also resulted in a marked increase in the NFC debt-to-assets ratio, interrupting the gradual reduction in leverage observed since the first quarter of 2009. It also explains the steep fall in the capital ratios of financial corporations when measured at market value. The "notional" capital-to-assets ratio of financial corporations – calculated by cumulating transactions over time and thus excluding the impact of asset price changes – declined by much less (0.1 percentage point), mainly reflecting the mechanical impact on both sides of the balance sheet of increased Eurosystem liquidity support. At the same time, financial corporations' substantial retained earnings and high recourse to equity markets (issuance of more than €100 billion in the third quarter of 2011) continued to contribute positively to the building-up of their capital base (Chart G).