

Box 4

INTEGRATED EURO AREA ACCOUNTS FOR THE SECOND QUARTER OF 2012¹

The integrated euro area accounts released on 30 October 2012, covering data up to the second quarter of 2012, offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. In the context of contracting economic activity, the household savings ratio again fell to a new record low, as consumers sought to mitigate the sharp fall of their disposable income in real terms. The profit margins of non-financial corporations (NFCs) decreased further, reaching low levels, but NFCs have not yet returned to their traditional net borrowing position, due to cuts in fixed investment, to destocking and to still substantial retained earnings. The reduction of government deficits continued, but at a slower pace, while the euro area external balance further improved, turning into a surplus on an annual basis. Households' net wealth declined significantly in the quarter under review, as a result of falling house and equity prices. The reduction of NFCs' leverage came to a halt, as a result of the negative impact on their wealth of losses on equity held, while financial corporations' capital ratios increased again, owing to equity issuance and higher retained earnings.

Euro area income and net lending/net borrowing

In reflection of the contraction of economic activity, the annual growth rate of nominal gross disposable income in the euro area declined markedly in the second quarter of 2012 (to 0.4%, after 1.8% in the first quarter) (see Chart A).

As euro area income expanded more slowly than total consumption (for the first time since the first quarter of 2010), there was a year-on-year contraction of gross saving. Households' saving ratio declined to the lowest level in historical terms in the second quarter of 2012. Government dissaving was reduced further, although it remained elevated. Retained earnings fell markedly in the case of NFCs in the second quarter (by 11%, year on year), while they rose for financial corporations. The growth of fixed capital formation in the euro area, expressed in annual terms, was negative

¹ 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**

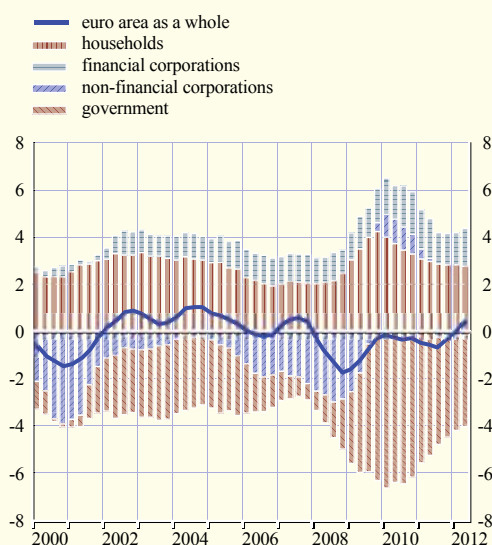
(annual percentage changes; percentage point contributions)



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.

and decreased further across all sectors, with the most pronounced declines being recorded for the government sector and for financial corporations. Households' investment declined by 2.1%, and that of NFCs by 1.1%. Destocking of inventories, assessed on the basis of seasonally adjusted data, appears to have gained further momentum in the second quarter; this contrasts with the significant restocking recorded a year earlier, so that inventories reduced the annual rate of growth in nominal GDP by 1 percentage point in the second quarter of 2012. As a result, overall gross capital formation fell far more markedly (by 7.4%, year on year) than gross fixed capital formation (2.7%).

Given that the decline in euro area investment was sharper than that in saving, the net lending/net borrowing position of the euro area improved (turning into a surplus of 0.3% of GDP on a four-quarter sum basis). The improvement in the external balance was due mainly to net trade in goods. From a sectoral viewpoint, the improvement reflected primarily increased net lending by financial corporations, the shift in the position of NFCs to slight net lending, from net borrowing a year earlier, mainly on account of destocking, and a steady reduction of government deficits. By contrast, households reduced net lending, as the contraction of saving exceeded the reduction of investment (see Chart B). On the financing side, cross-border flows were subdued, although non-residents resumed their investment in euro area government debt securities in the first half of 2012.

Behaviour of institutional sectors

In the second quarter of 2012, *households'* nominal income fell by 0.2%, year on year, after having increased by around 1.5% in the two previous quarters. This reflected lower growth in compensation of employees and a decline in both net property income earned and the gross operating surplus/mixed income. The negative fiscal drag on households' net income, i.e. that

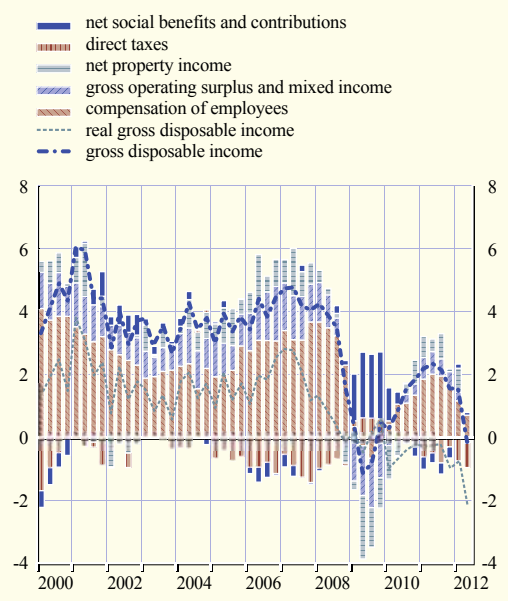
from government transfers and taxes, remained at the level recorded in previous quarters, reducing annual income growth by 0.7 percentage point. In real terms, households' income declined by 2.2%, year on year (see Chart C). In order to mitigate the effect of that decline on consumption, households dipped into their savings. This caused their saving ratio to fall, on a seasonally adjusted basis, to 12.9% in the second quarter, the lowest level on record (see Chart D).² As savings fell more rapidly than housing investment, households' net lending decreased. Growth of households' financing continued to edge down. The shifts in households' investment portfolios away from non-bank liabilities (notably insurance technical reserves) back to monetary assets (e.g. bank deposits) continued, in the context of an overall slowdown in financial asset accumulation. Households' net wealth fell significantly year on year, as their holding losses on housing and equity exceeded their net saving.

The gross operating surplus of *NFCs* contracted further on an annual basis in the second quarter, as value added decelerated relative to wages and as taxes on production increased. *NFC* margins fell further to 38.1% in the second quarter of 2012. This series had peaked at 41% in the third quarter of 2007, and had a trough of 36.6% in the first quarter of 2009. Savings (i.e. retained earnings) fell markedly in annual terms (by 11%), but remained at high levels. *NFCs*' net lending/borrowing has remained close to balance in recent quarters, thus not returning to the more traditional net borrowing position, as capital expenditure slowed down markedly in the

² This analysis is currently subject to higher statistical uncertainty than would normally be the case, with more scope for revisions than usual, as the financial side of the accounts pointed to a noticeably higher household saving ratio than the non-financial side prior to balancing.

Chart C Households' nominal gross disposable income

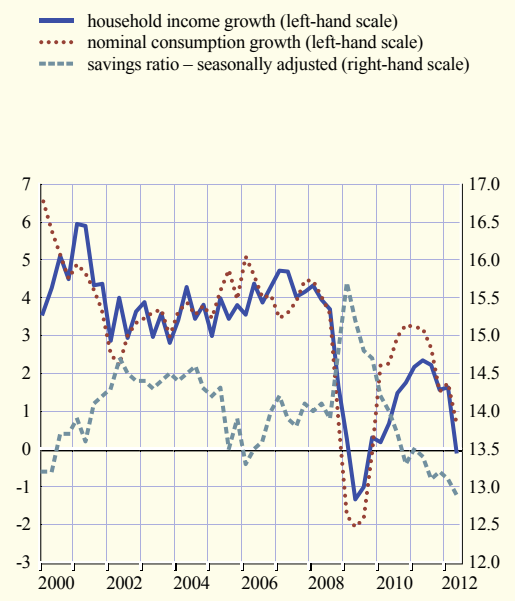
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' income, consumption and saving ratio

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



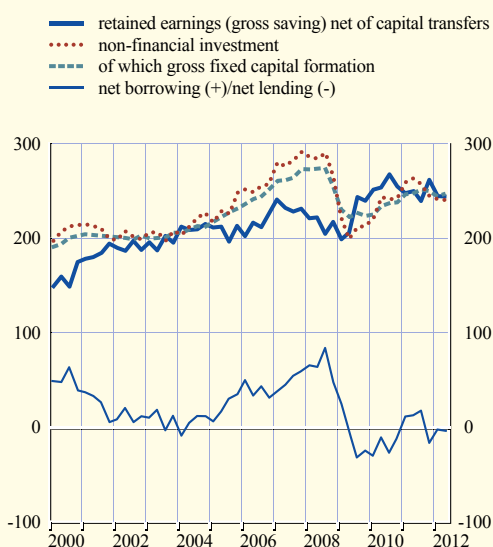
Sources: Eurostat and ECB.

context of destocking (see Chart E). NFCs' market financing benefited from the ECB's three-year longer-term refinancing operations (LTROs), which contributed to improving the environment for corporate debt issuance, whereas bank loans contracted again. NFCs continued to augment their already ample liquidity buffers (which stood at €2.8 trillion). In contrast to the rapid weakening of growth in value added, intra-sector lending (trade credits, loans granted by NFCs) remained resilient, once again providing a buffer for bank financing constraints, particularly in the case of small and medium-sized enterprises (Chart F). The reduction in NFCs' leverage came to a halt in the second quarter, as a consequence of lower equity prices diminishing the value of their portfolios, rather than as a result of an increase in debt.

In the second quarter of 2012, the *government* deficit, which has been falling fairly rapidly since its peak in the first quarter of 2010, declined further, albeit at a significantly slower pace. On a four-quarter moving sum basis, the government deficit fell to 3.9% of GDP in the second quarter, from 4.0% in the first quarter. Year-on-year growth in the government sector's current revenues declined (particularly VAT and direct taxes on corporations). Year-on-year growth in total expenditure remained contained at close to 1% (in nominal terms and excluding capital transfers), reflecting the ongoing consolidation measures, inter alia stagnant or declining compensation of employees. With respect to financing, loan liabilities have increasingly replaced debt issuance. Debt securities issued were bought by banks and non-residents alike, in the context of the ECB's refinancing operations (three-year LTROs), thus partly reversing the offloading of holdings observed in parallel to interventions under the Securities Markets Programme (SMP) in the second half of 2011.

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

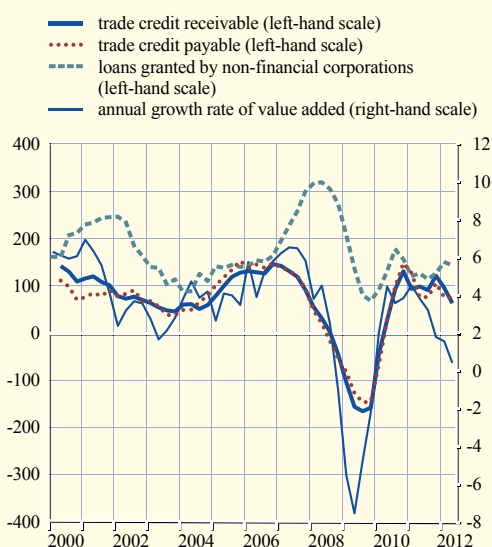
(EUR billions, seasonally adjusted)



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

Chart F Loans granted by non-financial corporations and their trade credit receivable and payable

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



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

The retained earnings (i.e. disposable income) of *financial corporations* increased sharply in spite of subdued growth in value added plus net interest earned, mainly as a result of higher net dividends earned on the back of lower dividends distributed. This, together with continued equity issuance and a reversal of previous holding losses on net assets in 2011, led to an increase in financial corporations' net assets at market value. Against the background of deleveraging pressures, additions to financial corporations' balance sheets remained subdued on a consolidated basis.

Balance sheet dynamics

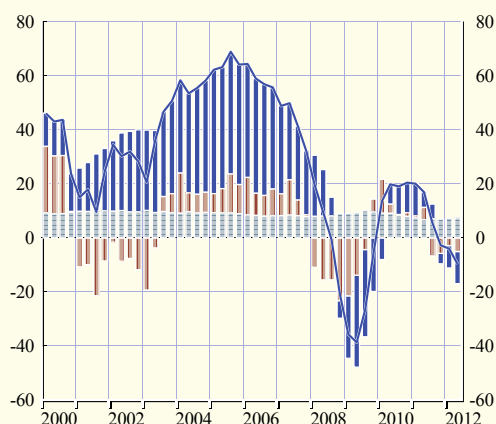
In the second quarter of 2012, the net worth of households fell markedly in year-on-year terms, namely by the equivalent of 9.6% of income (as opposed to increases in 2010, peaking at 20.5% of income in the fourth quarter). The positive influence of net saving (7.4% of income) was more than compensated for by the losses suffered by households (17.0% of income) on their holdings of non-financial assets (predominantly housing) and, to a lesser extent, on their portfolios of financial assets (see Chart G).

Financial corporations posted small holding gains on their financial assets in the second quarter of 2012, after significant gains in the first quarter (see Chart H). Holding losses on equity held (quoted shares, unquoted shares and mutual funds), due to falling stock markets,

Chart G Change in the net worth of households

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

- other flows in non-financial assets¹⁾
- other flows in financial assets and liabilities²⁾
- change in net worth due to net saving³⁾
- change in net worth

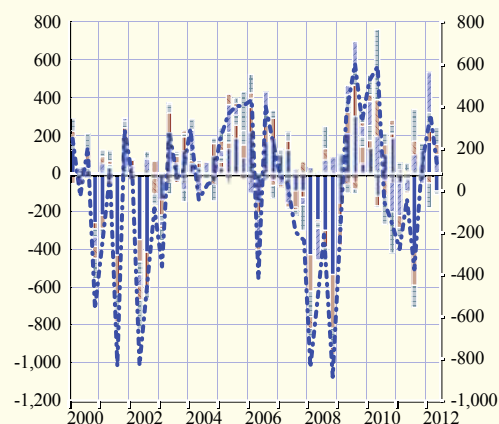


Sources: Eurostat and ECB.
Notes: Data on non-financial assets are estimates by the ECB.
1) Mainly holding gains and losses on real estate and land.
2) Mainly holding gains and losses on shares and other equity.
3) This item comprises net saving, net capital transfers received and the discrepancy between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

Chart H Gains and losses in financial corporations' asset holdings

(quarterly flows; EUR billions)

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



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).

and on government debt securities were offset by holding gains (and other effects, such as reclassifications) on other instruments that stemmed from the impact of the depreciation of the euro in the second quarter on assets denominated in foreign currencies (deposits and loans, as well as debt securities held). However, the depreciation of the euro also led to offsetting holding losses on liabilities denominated in foreign currencies. The effect of bad loans in loan portfolios generally remained limited, mainly as a result of the way in which loan impairments are accounted for, only gradually, in the euro area accounts.³

³ In international statistical standards, the impairment of loans is not usually recorded as an immediate change in balance sheet items outstanding, even though impairment charges may have been incorporated in the profit and loss account by the lender. Instead, the impaired loans are still recorded at their nominal value until such time as the partial or total derecognition of the affected loan balances is prescribed.