Box 5

INTEGRATED EURO AREA ACCOUNTS FOR THE THIRD QUARTER OF 2013[1]

The integrated euro area accounts, released on 28 January 2014 and covering data up to the third quarter of 2013, offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. The euro area's external surplus reached a historical high in the third quarter of 2013, mainly reflecting weak internal demand. Households' nominal income growth accelerated significantly, helping to stabilise real income. Their saving rate remains close to record lows, while the contraction in housing investment moderated again. Non-financial corporations (NFCs) remained in an unusual net lending position. Retained earnings rose at a slow pace, and capital formation increased slightly, as restocking more than compensated for the moderating fall in fixed investment. Business margins remained at very low levels. The government deficit was stable, although it edged down when capital transfers to banks are excluded. Regarding developments in indebtedness, debt-to-GDP ratios remained at high levels for all euro area sectors, although they declined slightly. However, the situation was more favourable when leverage, another measure of indebtedness, is considered. The trend towards strong NFC deleveraging resumed in the third quarter. Financial corporations' capital ratios again increased to very high levels. Households' net wealth rose in year-on-year terms, as net savings and equity gains more than offset falling house prices.

Euro area income and net lending/net borrowing

In the third quarter of 2013, the annual growth rate in nominal disposable income in the euro area increased anew (to 1%, year on year), reflecting the recovery in real GDP growth. This acceleration benefited primarily households' income (see Chart A).

With euro area consumption rising at broadly the same pace as income, growth in euro area gross saving again increased very slowly in the third quarter of 2013. The household saving ratio edged up marginally from historical lows, and NFCs increased their retained earnings slightly. The government sector stopped reducing its dissaving. The pace of year-on-year decline in fixed capital formation by both NFCs and households in the euro area moderated again in the third quarter, to -1.6% and -1.1% respectively, compared with -2.9% and -2.1% in the previous quarter, while fixed capital formation by the government returned to positive territory (0.6%). Moderate restocking resumed in the third quarter, so that euro area capital formation was broadly unchanged, year on year.

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

(annual percentage changes; percentage point contributions)

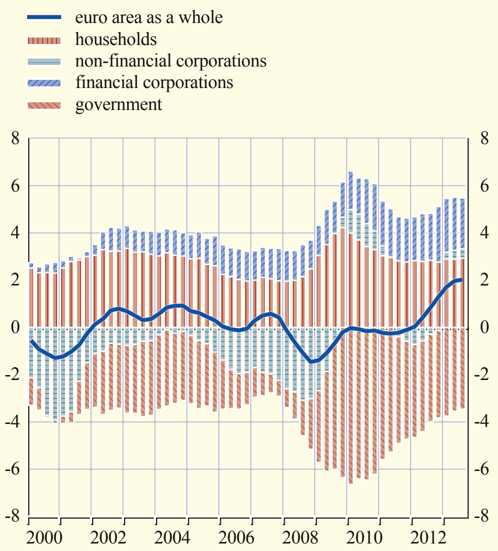
Sources: Eurostat and ECB.

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

With euro area capital formation broadly stable and savings growing slowly, net lending stabilised in the third quarter, standing at 2% of GDP on a four-quarter-sum basis, the highest aggregate level recorded for the euro area countries since at least 1970. This stabilisation resulted from a further improvement in net trade that was offset by a fall in net property income earned. From a sectoral point of view, it reflected broadly unchanged sectoral balances (see Chart B). NFCs continue to show an unusual net lending position. The lack of any further reduction of the government deficit largely reflected significant capital transfers to banks, which in turn inflated the net lending position of financial corporations. On the financing side, cross-border flows remained subdued, with non-residents continuing to substitute deposits for debt securities and equity in the third quarter.

Chart B Net lending/net borrowing of the euro area

(percentages of GDP; four-quarter moving sums)



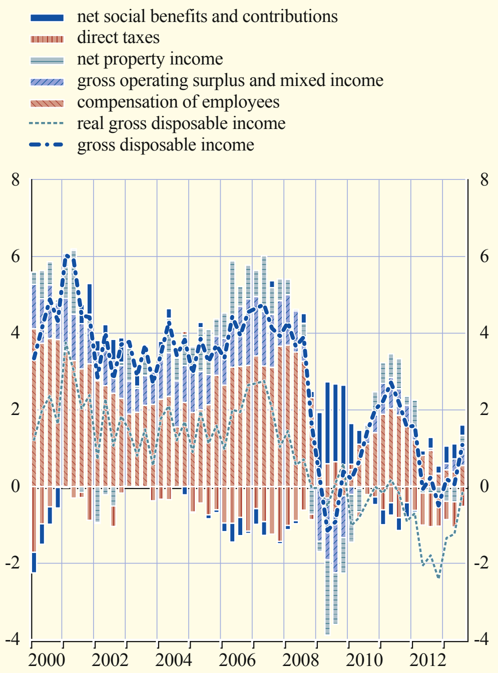
Sources: Eurostat and ECB.

Behaviour of institutional sectors

Households' nominal income growth accelerated significantly in the third quarter of 2013 (to 1.1%, year on year, after 0.1% in the second quarter), as a result of an upturn in net property income earned and an accelerated increase in the gross operating surplus and mixed income, as well as (to a lesser extent) in compensation of employees (see Chart C). The fiscal drag (households' net transfers to and from government) again reduced annual income growth by 0.2 percentage point in the third quarter. Coupled with weak price dynamics, the decline in real income virtually came to a halt (after it had bottomed-out at -2.4% in the fourth quarter of 2012). With nominal consumption growing at a somewhat slower pace than income, the household saving ratio rose slightly from its record low, to 13.1% in seasonally adjusted terms in the third quarter (see Chart D). The pace of contraction of housing investment moderated again, resulting in a marginal increase, on a four-quarter-sum basis, in households' net lending. Growth in household financing remained at very low

Chart C Households' nominal gross disposable income

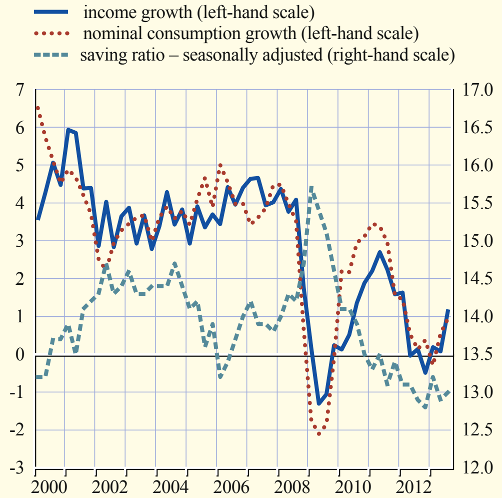
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' income, consumption and saving ratio

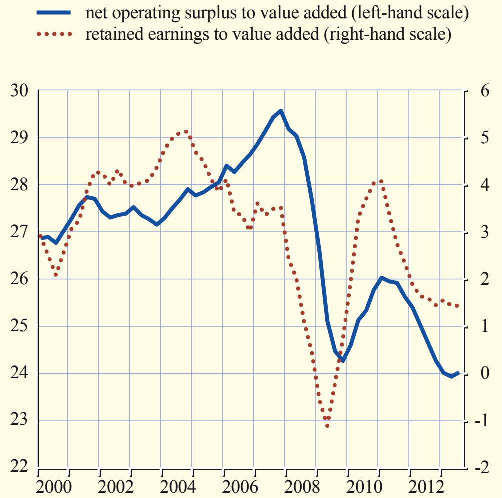
(annual percentage changes; percentage of gross disposable income, seasonally adjusted)



Sources: Eurostat and ECB.

Chart E Non-financial corporations' margins

(percentages, four-quarter average)



Sources: Eurostat and ECB.

levels, as borrowing from banks remained weak. On the asset side, households continued to shift portfolio holdings into bank deposits, insurance technical reserves and mutual fund shares, away from debt securities. The household debt ratio declined, as did the leverage ratio, as net wealth rebounded somewhat, year on year, reflecting net saving and gains on equity that together exceeded holding losses on housing (see Chart H).

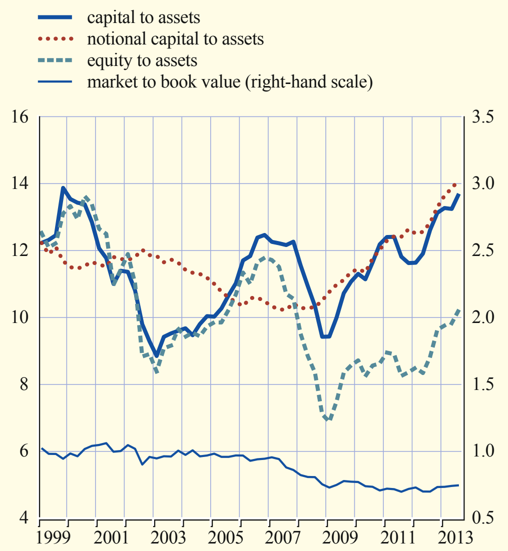
The growth of the gross operating surplus of *NFCs* increased further in the third quarter, to 2.4%, year on year, since the recovery of value added outpaced that of wages. Business margins, as measured by the net operating surplus (i.e. net of consumption of fixed capital)[2] in terms of value added, remained at the low reached in the first quarter of 2013, 1 percentage point below the post-Lehman trough (four-quarter sums – see Chart E). At the same time, a number of factors, including low (and falling) net interest paid and relatively low (but increasing) net dividends paid, continued to contribute to keeping NFC savings (retained earnings) at relatively elevated levels. The pace of decline in fixed capital expenditure moderated slightly, to -2.1%, year on year, with NFC investment, expressed as a proportion of value added, remaining close to its historical low. At the same time, as businesses restocked somewhat on a seasonally adjusted basis in the third quarter, possibly signalling a reversal in the inventory cycle, NFCs' capital formation increased slightly on a year-on-year basis. NFCs retained their unusual net lending position (see Charts B). Substituting for contracting bank lending (-€145 billion over four quarters, in net terms), NFCs continued to tap the bond market (€89 billion) and the stock market (€20 billion) for financing, and to borrow rather actively from other financial corporations

2 When measuring firms' profitability on the basis of the national accounts data, the focus should be on the net operating surplus, rather than on the gross operating surplus, because consumption of fixed capital (i.e. the amortisation of plant and equipment over several years) should be excluded. Given that consumption of fixed capital represents a fixed cost of business, it tends to move exogenously and steadily throughout the business cycle. As a result, a measure of net profit tends to be more sensitive to the business cycle than a measure of gross profits.

(€119 billion), largely reflecting corporate bond issuance via conduits, but also, to a major extent, one-off operations related to bank restructuring in Spain. Intra-sector lending, comprising loans extended by other NFCs and the bulk of trade credits (which are important for small and medium-sized enterprises that face bank financing constraints), remained subdued in the third quarter. NFCs continued to build up their liquidity buffers (which stand at €2.7 trillion). The significant deleveraging process continued, helped by valuation gains on equity held by NFCs (see Chart G).

Chart F Capital ratios of financial institutions excluding mutual funds

(percentage of total assets)



Source: ECB.
Notes: "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. Assets and liabilities are valued at market value. The ratio of "notional capital to assets" is calculated on the basis of transactions in capital and assets, i.e. excluding holding gains/losses on (changes in prices of) assets and liabilities.

The *government* deficit was stable in the third quarter (3.5% of GDP on a four-quarter-sum basis), although it edged down when significant bank recapitalisations are excluded (0.6% of GDP). Growth in receipts moderated. Excluding capital transfers, government expenditure picked up somewhat, to 2.4% in nominal terms. Although the increase in compensation of employees remained limited (0.3%, year on year), the growth of other components of current spending was much higher. Investment expenditure expanded slightly, posting the first positive year-on-year growth since the third quarter of 2009. Debt issuance continued to fund large deficits, as well as significant, albeit falling, net purchases of financial assets.

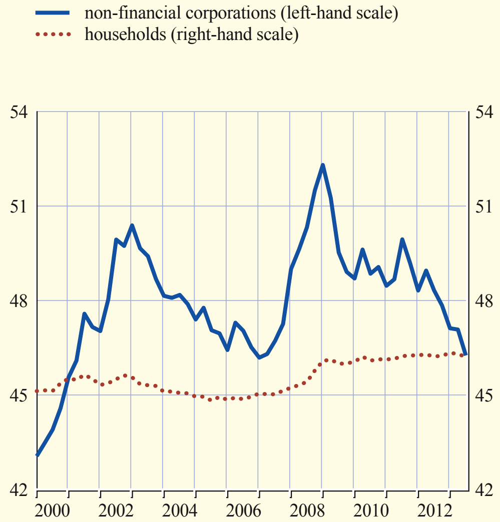
In the third quarter of 2013, the disposable income of *financial corporations* continued to decline year on year, albeit at a slower pace, as value added and net interest earned (taken together) continued to contract, and as tax payments rose. In this context, the high net lending position of financial corporations moderated somewhat on a four-quarter-sum basis, notwithstanding the high capital transfers received from government over the year. Financial corporations' net assets at market value (an aggregate measure of "capital") increased, reflecting holding gains, still sizeable net retained earnings (€36 billion in the third quarter) and capital transfers received. Equity issuance remained low, also reflecting sizeable disinvestment in special-purpose entities. Financial corporations' capital ratios are now particularly elevated (see Chart F). The stock market valuation of financial corporations increased more than the market value of their net assets, but still remains significantly lower than the latter, reflecting continued market distrust. Financial corporations' financial investment growth moderated to very low levels on a consolidated basis.

BALANCE SHEET DYNAMICS

In relation to developments in indebtedness, debt-to-GDP ratios continued to fall very slowly across sectors, but remained at high levels in all of them. The picture is more favourable, however, when leverage, another measure of indebtedness, is considered: debt-to-asset ratios

Chart G Sectoral leverage

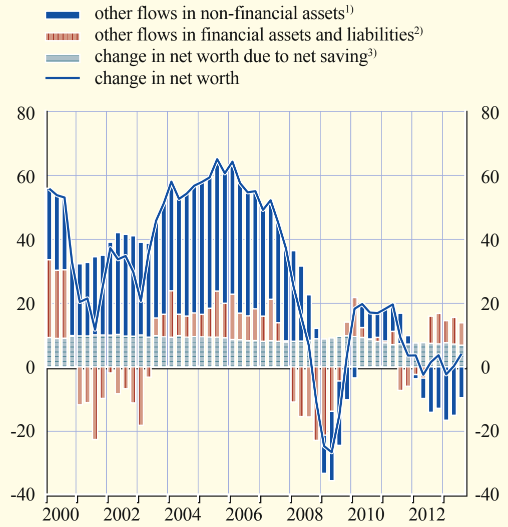
(percentages of assets)



Sources: Eurostat and ECB.
Notes: Calculated as a ratio of total debt liabilities to total assets. Total assets comprise all financial assets and most non-financial assets.

Chart H 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) Mainly holding gains and losses on real estate (including 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.

(including non-financial assets) fell in all four sectors (NFCs, financial corporations, households and government) in the third quarter of 2013, although the pace differed. The international investment position (i.i.p.)[3] of the euro area improved again, to -19.3% of GDP.

The trend towards substantial NFC deleveraging resumed in the third quarter, owing to holding gains on equity held in the quarter (see Chart G). Households' leverage edged down from high levels, as the net wealth of households rebounded, increasing, year on year, by the equivalent of 4.1% of their income. The positive impact of net saving (6.8% of their annual income up to the third quarter of 2013), and of holding gains (over one year) on their financial portfolios (7.0% of income), more than compensated for the significant holding losses on non-financial assets (housing: -9.7% of income) (see Chart G). Financial corporations' notional capital ratios increased again, to very high levels (see Chart F).

3 The i.i.p. measures the net asset position of residents vis-à-vis non-residents: assets net of liabilities (including equity).