Box 1

THE ROLES OF VARIOUS INDUSTRIES IN RECENT DEVELOPMENTS IN MFI LOANS TO NON-FINANCIAL CORPORATIONS

A stylised fact relating to the credit cycle is that turning points in the annual growth of MFI loans to non-financial corporations lag those in GDP growth by around three to four quarters.[1] The increases observed in recent months in the annual growth rate of loans to non-financial corporations suggest that this growth rate bottomed out in the first quarter of 2010, which would be in line with historical regularities. However, such historical regularities represent an average outcome across a number of different business and credit cycles. Consequently, they cannot be expected to hold completely in each individual cycle. For instance, deviations may occur if the various industries in the non-financial corporation sector differ in terms of their propensity to obtain financing through bank loans, or if their conjunctural developments

1 See the box entitled "Loans to the non-financial private sector over the business cycle in the euro area", *Monthly Bulletin*, ECB, October 2009.

are highly unbalanced or shift in strength. Against this background, this box discusses recent developments in MFI loans to non-financial corporations by industry, using a dataset for the euro area that will, from now on, be disseminated regularly by the ECB.[2]

The shares of the various industries in total loans to non-financial corporations

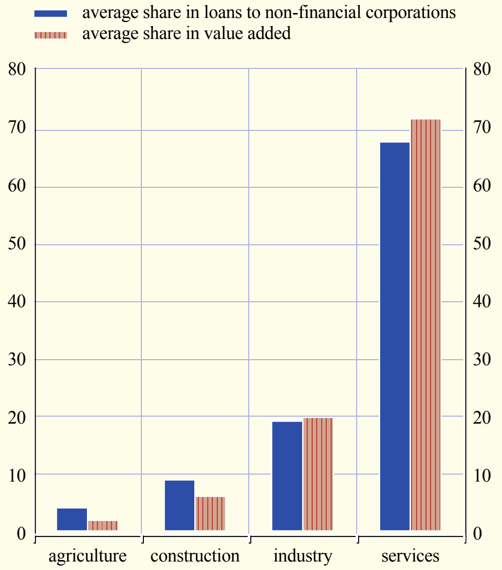
Data on euro area loans are available for ten selected industries. However, for the purposes of this box and to allow a comparison with economic activity, these industries are clustered together in four relatively broad groups.[3] Of these, services were the recipient of the largest share of total loans to non-financial corporations between the first quarter of 2003 and the second quarter of 2010 (accounting, on average, for around 68% of loans), followed by industry (which accounted for around 19%), construction (9%) and agriculture (4%) (see Chart A).

All of these shares broadly correspond to the industries' respective shares in total value added. However, some differences can be highlighted, even taking into account the fact that the breakdowns available are not fully comparable (as the industry definitions for the two sets of data are not identical). In particular, the construction and agricultural industries' shares in value added are – at 6% and 2% respectively – significantly lower than their shares in loans, while the opposite is true for services. Within services, the share of real estate and business administration activities in the total volume of loans is, in particular, larger than these sectors' share in total value added.

Such differences reflect the various financing and liquidity modalities of individual industries, such as access to market financing or the possibility of drawing on internal funds. However, they also reflect the nature of the production process where, for instance, high levels of fixed costs are incurred in the early stages of the production process and cash flow is available only late in the process. Industries that for one or more of these reasons have a high degree of "loan intensity" (i.e. a high ratio of bank loans to value added) are, for instance, construction, real estate and agriculture.

Chart A Shares in outstanding amounts of loans to non-financial corporations and value added by industry

(percentages)



Source: ECB.
Notes: Averages over the period from the first quarter of 2003 to the second quarter of 2010. See footnote 3 for a precise definition of the broad industry groupings shown in the chart.

2 For more information on the degree of harmonisation, coverage and timeliness of these data, see the explanatory note of November 2010 entitled "Loans from euro area monetary financial institutions to non-financial corporations by branch of activity" available on the ECB's website. See also the discussion in the box entitled "Developments in MFI loans to non-financial corporations by industry", *Monthly Bulletin*, ECB, December 2009.

3 The groups are as follows: "agriculture" comprises agriculture, forestry and fishing; "construction" comprises construction; "industry" comprises manufacturing, mining, and the supply of electricity, gas and water; and "services" comprise real estate and administrative activities, wholesale and retail trade, transportation and communication, as well as "other" services. The breakdown of loans to non-financial corporations used in this box does not include Section K (financial and insurance activities) or Section O (public administration and defence; and compulsory social security) of the NACE Rev.2 classification. For both of these sections, it is assumed that the corresponding institutional sectors are predominantly part of the financial corporation sector and the general government sector, rather than the non-financial corporation sector.

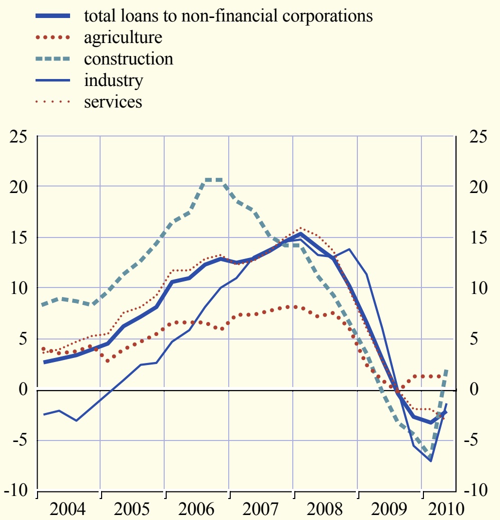
The contributions made by the various industries to recent developments in total loans to non-financial corporations

The latest available data suggest that the annual growth rates of loans to firms in construction and industry may have bottomed out in the first quarter of 2010, before increasing in the second quarter (albeit remaining in negative territory in the case of industry; see Chart B). By contrast, the annual growth rate of loans to services not only remained negative in the second quarter of 2010, but decreased slightly further. On balance, the less negative contributions by construction and industry more than offset the more negative contribution by services. Thus, the annual growth rate of total loans to non-financial corporations increased in the second quarter of 2010 and gave rise to expectations that a turning point had been reached in the loan growth cycle (see Chart C).

Looking at the economic cycle (measured by the annual growth rate of real GDP), the recovery that began in the first half of 2009 was driven largely by a strengthening in the growth of industrial output. By contrast, growth in construction output has been lagging behind, with annual growth remaining clearly in negative territory in the second quarter of 2010. This uneven recovery stands out by comparison with previous recoveries – such as those of the early 1990s and early 2000s, where the recoveries seen in the output growth of industry and construction were more in line with each other – and could have implied a delay in the recovery of growth in total loans to non-financial corporations. In particular, the fact that the construction sector has been lagging behind implies that this sector has made a negligible contribution to the growth of total loans to non-financial corporations, rather than the significant contribution that could probably have been expected given the typically high loan intensity of this sector.

Chart B Annual growth rates of loans to non-financial corporations by industry

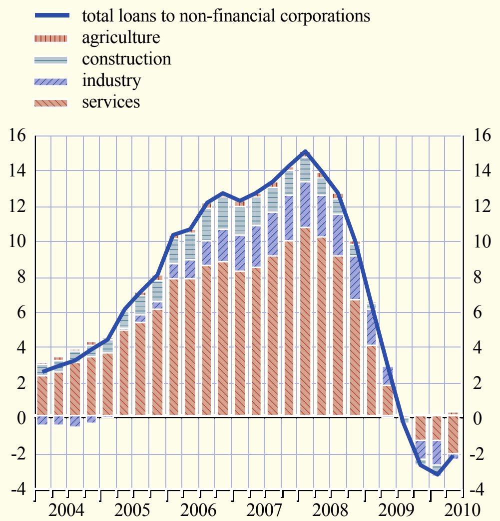
(annual percentage changes)



Source: ECB.
Note: See footnote 3 for a precise definition of the broad industry groupings shown in the chart.

Chart C Contributions to the annual growth rate of loans to non-financial corporations by industry

(annual percentage changes; percentage points)



Source: ECB.
Note: See footnote 3 for a precise definition of the broad industry groupings shown in the chart.

However, the fact that the recovery observed in manufacturing output has been stronger than usual has meant that, despite the lower loan intensity of this industry, the recovery in the growth of total loans to non-financial corporations has not been delayed by comparison with previous recoveries. The pattern of output growth for services has been broadly in line with that of growth in total value added, although the depth of the downturn and the strength of the recovery have both been more muted than in the case of industry. As the time series for loans by industry is relatively short, it is not possible to assess whether the current lag in the growth of loans to the service industry relative to growth in value added in this industry is a normal feature of the business cycle. However, some of this lag might be due to the recent recession having a particularly strong impact on certain sectors within services, such as real estate, where loan intensity is high.

Conclusion

Overall, the recent upturn in the annual growth rate of MFI loans to non-financial corporations has been driven mainly by recoveries in loans to firms in construction and industry. By contrast, growth in loans to the service industry is still lagging behind. However, the strong output growth observed recently for services may soon encourage firms in these sectors to increase their recourse to loans, with the recovery in total loan growth becoming more broadly based and evidence of a turning point in the loan cycle strengthening further.