Box 4

INTEGRATED EURO AREA ACCOUNTS FOR THE FOURTH QUARTER OF 2010[1]

The integrated euro area accounts up to the fourth quarter of 2010 that were released on 3 May 2011 offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. The latest data point to a continued recovery of the euro area economy. Private consumption has remained fairly resilient so far, while investment flows were less dynamic in the second half of 2010, after an initially stronger rebound in the wake of the financial crisis. The household saving rate has fallen to very low levels, while non-financial corporations (NFCs) are only gradually reverting to their traditional net borrowing. Disintermediation has remained a salient feature of this recovery, despite signs of a partial reversal of the earlier substitution of bank by market funding.

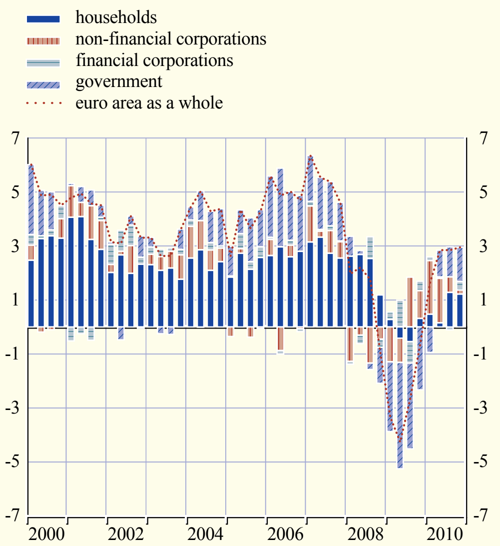
Euro area income and net lending/net borrowing

Nominal gross disposable income in the euro area continued to rise in the fourth quarter of 2010, at an annual growth rate of 3%, benefiting all sectors and, in particular, government (see Chart A).

1 Detailed data can be found on the ECB's website.

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

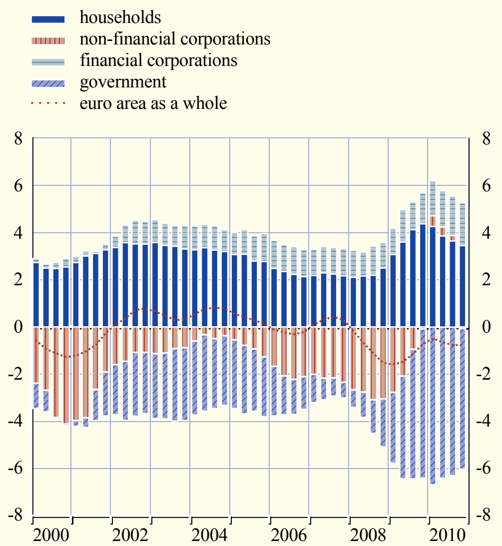
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart B Net lending/net borrowing of the euro area

(as a percent of GDP; four-quarter moving sum)



Sources: Eurostat and ECB.

Euro area saving increased significantly, year on year, on the back of an expansion in euro area income that was faster than that in total consumption (marked by noticeably lower government consumption growth), with government saving contributing the most, while household savings continued to decline. Gross capital formation continued to expand, year on year – helped by slower destocking – despite some moderation towards the end of the year.

With an increase in euro area saving commensurate to that of total investment, the net borrowing of the euro area stabilised (at 0.8% of GDP, expressed as a four-quarter sum). From a sectoral point of view, this stabilisation reflects some further rebalancing between sectors, with another reduction in government net borrowing (the government deficit fell to 6% of GDP in 2010) and a further decline in households' net lending, while the net lending position of NFCs turned into a small net borrowing position.[2] (see Chart B).

The mirror image of these developments can be seen in the external accounts, which showed a stable current account deficit. On the financing side, cross-border transactions expanded, with the episode of rapidly contracting interbank deposits (between euro area MFIs and foreign banks) coming to an end.

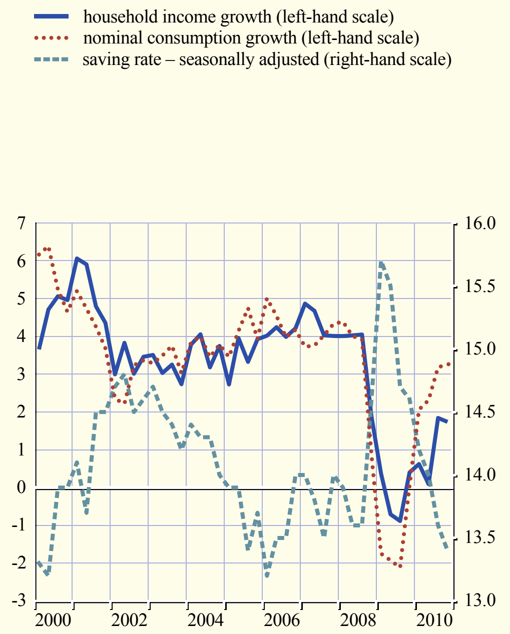
Behaviour of institutional sectors

Households' nominal income growth (+1.8%, year on year) was driven mainly by rising salaries and high property income earned in the fourth quarter of 2010, while income streams originating from government (e.g., net social transfers and tax payments) generally contributed

2 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 measure the difference between transactions in financial assets and transactions in liabilities.

Chart C Household income and consumption growth, and savings ratio

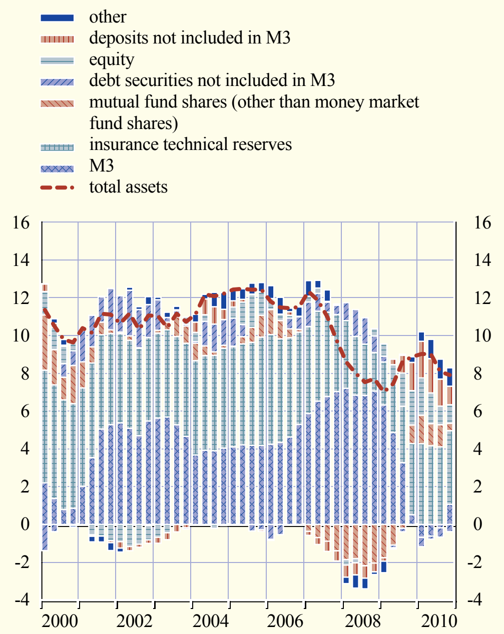
(annual percentage changes; percentage of gross disposable income; four-quarter moving sum)



Sources: Eurostat and ECB.

Chart D Households' financial investment

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



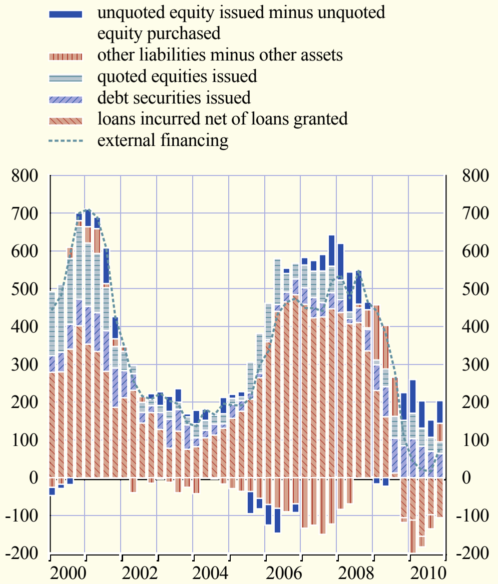
Sources: Eurostat and ECB.

negatively. Whereas household income continued to contract in real terms, on the back of high commodity prices, private consumption remained fairly resilient, as households chose to draw on precautionary savings (unlike the situation in the previous episode of commodity price shocks in 2008). Accordingly, their savings ratio declined to 13.4% on a seasonally adjusted basis, close to the lowest level recorded over the past decade, in a context of improving employment outlook, increasing household wealth and a rebound in some housing markets (see Chart C). With subdued investment, households' net lending fell markedly, and the growth of loans taken out remained at moderate levels. On the assets side, the pattern of portfolio allocation continued to reflect a search for yield and an increasing risk appetite, with very small flows into the low-yielding instruments included in M3 for several quarters (see Chart D).

The gross operating surplus of *NFCs* continued to recover on the back of solid value added growth and despite a notably faster increase in compensation of employees. However, the dynamic development of direct taxes paid and dividends distributed, as well as lower interest earned, caused NFC saving to be less dynamic (and to contract somewhat, quarter on quarter, albeit from a very high level). The net lending position of NFCs thus returned to a net borrowing position, despite subdued NFC investment (see Chart B). The growth rate of NFCs' external financing increased slightly, with still visible substitution effects, despite a certain slowdown in market financing (debt securities and quoted shares: +€26 billion in the second half of 2010) and less pronounced net redemptions in MFI loans than before (-€8 billion in the second half of 2010) (see Chart E). The ongoing deceleration of growth in market funding may partly reflect a certain normalisation in credit markets. At the same time, intrasector funding (trade credits, loans granted

Chart E External financing of non-financial corporations, by source of funds

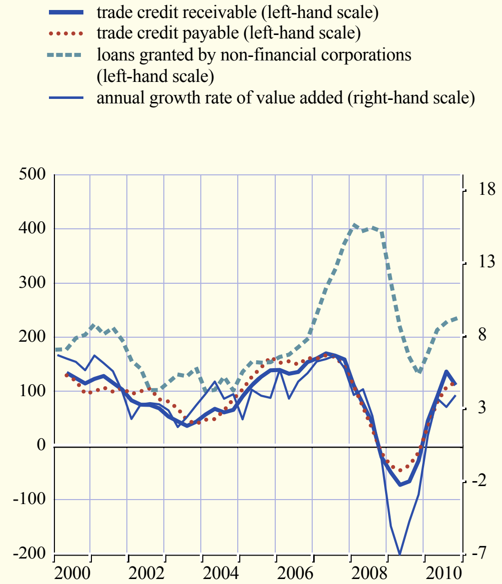
(four-quarter moving sum; EUR billions)



Source: Eurostat and ECB.
Note: For presentational purposes, some transactions in assets are netted from financing, as they are predominantly internal to the sector (loans granted by non-financial corporations, unquoted shares, other accounts receivable/payable).

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

(four-quarter moving sum 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.

by NFCs, unquoted shares) still expanded rapidly, suggesting that customer-supplier relationships continued to play a buffering role, as some companies may still be credit-constrained. After the bankruptcy of Lehman Brothers, trade credit had contracted noticeably less than value added, mitigating the lack of bank credit (notably for small and medium-sized enterprises) and/or poor market access. During that period of funding stress, loans granted by NFCs (mostly intragroup funding) had even accelerated (see Chart F). In addition, NFCs increased their liquidity buffers substantially further (deposits but also debt securities) and stepped up their purchases of quoted equity.

General government accounts improved further (from a peak deficit of 6.7% in the first quarter of 2010), reflecting the economic recovery as well as the impact of consolidation measures. Taxes and social contributions grew year on year, while compensation of government employees contracted on a year-on-year basis, for the first time on record, and social benefits and interest expenditure growth remained contained. Debt issuance increased noticeably, in parallel with a sharp build-up of financial assets, primarily on account of the operation of a specific German bad bank. The defeasance structure set up for this operation in the fourth quarter of 2010 to carry the impaired assets is classified, in line with the rules of the ESA 95, as belonging to the government sector and is seen to have incurred large liabilities to fund the acquisition of the impaired assets.

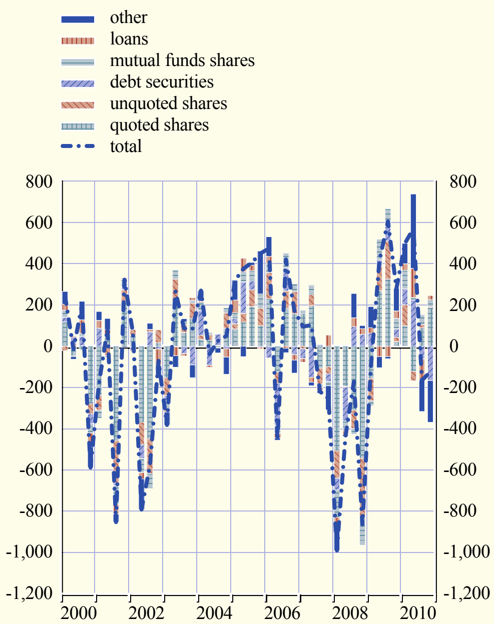
The sharp increase in *financial corporations'* disposable income resulted mainly from the fact that dividends earned were higher than dividends paid, while both their value added and their gross operating surplus contracted year on year. Sizeable net retained earnings (€165 billion, including net capital transfers, in 2010), together with holding gains on equity, compensated for valuation losses on debt securities held (stemming from a steepening yield curve and turmoil in some government debt markets) and on instruments denominated in US dollars (see Chart G). In a context of deleveraging pressures, additions to financial corporations' balance sheets (excluding interbank deposits) remained subdued, amounting to, on average, €200 billion per quarter, compared with up to €1.2 trillion during the preceding leverage boom. At the same time, the previous shift towards safer assets started to reverse. However, the pattern of pronounced financial disintermediation that emerged after the bankruptcy of Lehman Brothers has only partially receded so far: households' portfolio allocations still favour non-monetary assets and NFCs' external financing continues to draw heavily on inter-company funding and on still dynamic (although slowing) market funding.

Financial markets

On the debt securities market, the government sector stepped up its issuance, while NFCs reduced their recourse to the debt securities market and MFIs continued their significant net redemptions of such liabilities. Non-monetary financial intermediaries other than insurance corporations and pension funds (generally referred to as "OFIs"), insurers and NFCs added to their portfolios of debt securities held, while households and MFIs sold such assets. The rest of the world did not revert to the role of a significant net buyer it had played from mid-2008 to mid-2010. On the mutual funds market, issuance of non-money market mutual fund shares continued at elevated levels (in contrast to heavy redemptions in money market mutual fund shares), reflecting households' appetite for riskier and longer-term assets. On the market for quoted shares, net issuance moderated somewhat for both MFIs

Chart G Holding gains and losses in financial corporations' assets

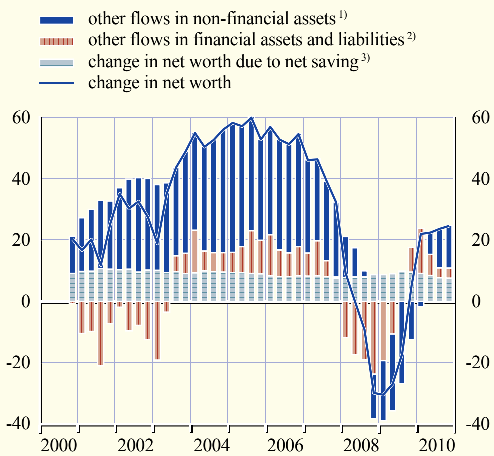
(quarterly flow; EUR billions)



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).

Chart H Change in net worth of households

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



Sources: Eurostat and ECB.
Note: 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.

and NFCs. All domestic sectors again became heavy buyers: investment funds in the OFI sector, but also MFIs, NFCs and households, while non-residents were heavy sellers. On the loan market, NFCs slowed their continued redemption of MFI loans, in particular in the short-term segment, while the growth of households' borrowing remained stable.

Balance sheet dynamics

In the fourth quarter of 2010, the net worth of households continued to grow at a significant annual rate that came down to 24.6% of their income. Aside from the positive influence of net saving (7.6% of income – gradually declining on the back of falling savings ratios), households benefited from holding gains (17% of income) on equity, reflecting a substantial recovery of equity prices, year on year, up to the end of 2010, and on property. Residential property prices have now been rising, year on year, for three quarters in a row, after six consecutive quarters of decline (see Chart H).