Box 5

INTEGRATED EURO AREA ACCOUNTS FOR THE SECOND QUARTER OF 2014[1]

This box discusses the integrated euro area accounts, released on 27 October 2014 and covering data up to the second quarter of 2014. The integrated euro area accounts offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area, as well as on their balance sheet positions. For the first time, the data on the financial and non-financial accounts referred to below are based on the new European System of Accounts (ESA 2010). In addition to methodological changes and revisions due to the introduction of new data sources, the change-over results in a more detailed breakdown, by subsector, of the financial accounts of financial corporations, and in a more detailed breakdowns of financial assets and liabilities (see also Box 8).

Summary of the main results

The euro area's external surplus was broadly unchanged at 2.1% of GDP (on a four-quarter-sum basis) in the second quarter of 2014, thus remaining at the highest level recorded since the launch of the euro. The current level of net lending by the euro area reflects the deleveraging of balance sheets by the non-financial private sector and weak internal demand, as well as fiscal consolidation, which has resulted in lower government deficits. The net external asset position of the euro area improved significantly, after having deteriorated moderately in the previous quarter. This improvement mirrored primarily the positive net lending position of the euro area and, to a somewhat lesser extent, valuation gains due to relative asset price and exchange rate changes.

Households' nominal and real income growth decelerated slightly. Households increased their consumption and maintained their savings rate at a very low level. Housing investment turned negative again, following the first rise in two years in the previous quarter. The net lending of non-financial corporations (NFCs) remained at about 0.5% of GDP, thus continuing to fluctuate around this level for the sixth consecutive quarter. The growth of fixed capital expenditure, which decelerated in year-on-year terms, was offset both by a moderation in retained earnings and by some destocking. Business margins remained at very low levels. General government net borrowing was 2.6% of GDP (on a four-quarter-sum basis), down from 2.7% in the first quarter.

Regarding developments in indebtedness, gross debt-to-GDP ratios remained high for all euro area sectors. Moreover, they increased in the case of all sectors except households. However, the financial picture according to other leverage measures, such as the debt-to-assets, capital and net worth ratios, is more favourable. The debt-to-assets ratio of NFCs stabilised in the second quarter of 2014, after having declined significantly since mid-2013. Underlying this stabilisation was a strengthening of debt financing that was offset by increased assets, stemming mainly

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

from the impact of further holding gains on total equity. Financial corporations' headline capital ratios increased moderately further, to stand at relatively high levels, which could partly reflect supervisory requirements and preparations for the completion of the ECB's asset quality review (AQR) in the third quarter. Households' net worth rose again in year-on-year terms, on account of continued increases in securities' prices, while losses on holding real estate moderated.

Euro area income and net lending/net borrowing

Nominal gross disposable income in the euro area grew by 1.2%, year on year, in the second quarter of 2014, down from 2.1% in the previous quarter. This deceleration in income growth reflected the low quarterly increase in real GDP in the second quarter, while price dynamics remained weak. Income growth slowed down sharply for NFCs (turning negative) and, to a lesser extent, also for households and the government sector. Income growth for financial corporations turned positive, however, for the first time since the first quarter of 2012, when seen in year-on-year terms (see Chart A).

Gross savings in the euro area declined modestly in the second quarter of 2014 (on a four-quarter sum basis). The household saving ratio fell slightly, thus remaining at a historically low level, while NFCs slightly moderated their retained earnings and government savings increased (on a four-quarter-sum basis). The growth of gross fixed capital formation in the euro area decreased from 2.3% in year-on-year terms in the first quarter to -0.2% in the second quarter. This change was driven mainly by a deceleration of NFCs' investment growth, which was rather flat, year on year, as well as by developments in household and government investment, which turned negative in both cases.

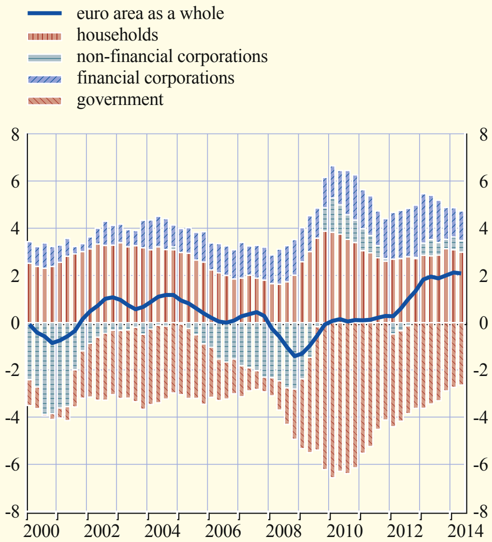
Chart A Gross disposable income in the euro area and contributions by sector

(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.

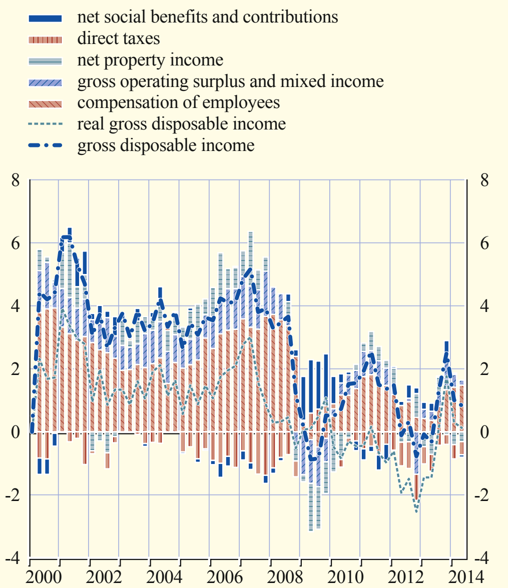
The euro area's net lending stabilised in the second quarter, at 2.1% of GDP on a four-quarter-sum basis. It thus remained at the highest level recorded since the inception of the euro. From a sectoral point of view, the government deficit declined by 0.1 percentage point, to 2.6% of GDP (on a four-quarter-sum basis), counterbalanced by a decrease of 0.1 percentage point in households' net lending position, to 3.0% of GDP (see Chart B). NFCs showed a net lending position for the seventh consecutive quarter. On the financing side, robust net purchases by non-residents of debt securities and equity issued by euro area residents point to positive foreign investor sentiment vis-à-vis the euro area.

Behaviour of institutional sectors

Households' nominal income growth declined slightly in year-on-year terms in the second quarter of this year, as compared with the previous quarter (0.8%, after 1.0%). The factors underlying this broad stability in household income growth all changed little. Income from self-employment contributed 0.2 percentage point less than in the previous quarter, and the contribution of direct taxes, net property income and net social benefits received declined by 0.1 percentage point. At the same time, the contribution of compensation per employee increased by 0.1 percentage point (see Chart C). Against the background of weak price dynamics, real income growth totalled 0.1%, year on year, in the second quarter of this year, down from 0.3% in the previous quarter. With nominal consumption growth increasing further and outpacing income growth, the household saving ratio decreased by 0.2 percentage point in the second quarter, to 12.9%, and thus continued to fluctuate around 13% (see Chart D). Housing investment growth turned negative (-0.3%, year on year), after the previous quarter had seen the first positive growth rate in two years. Consequently, households' net lending declined on a four-quarter-sum basis. Households' total loan financing

Chart C Households' nominal gross disposable income

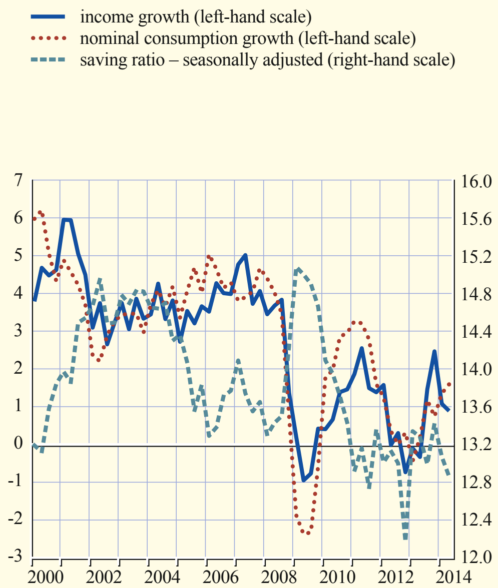
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' income, consumption and saving ratio

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



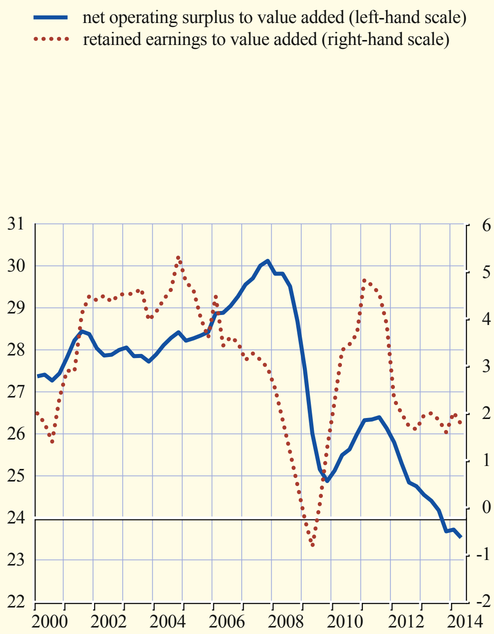
Sources: Eurostat and ECB.

was unchanged in the second quarter of 2014, as borrowing from banks remained weak. On the assets side, households' financial investment remained at values close to the historical low reached in the previous quarter, reflecting still weak income growth and deleveraging needs in a number of countries. Households continued to allocate savings to deposits, as well as to life insurance and pension products. At the same time, they increased their mutual fund share holdings significantly and moved away from debt securities and direct equity holdings. The household leverage ratio declined as net worth increased further, year on year (see Chart I). The latter reflected continued gains on security holdings and positive net savings, which together exceeded moderating holding losses on real assets and, in particular, real estate by a considerable margin. The household debt-to-assets ratio also declined marginally (see Chart H).

The year-on-year growth of the gross operating surplus of NFCs decelerated in the second quarter, as value added growth slowed down, while wage growth stabilised. Business margins, as measured by the ratio of the net operating surplus (i.e. net of consumption of fixed capital) to value added, declined slightly further, and thus remained at a very low level (see Chart E). At the same time, the ratio of retained earnings to value added continued to fluctuate around 2%, as seen since early 2012. NFCs' savings (i.e. retained earnings) moderated slightly in terms of four-quarter sums. An important underlying factor was a further reduction of interest paid. Gross fixed capital formation declined to 0.2%, in terms of year-on-year growth, marking the fourth consecutive quarter of positive growth. The net lending position of NFCs remained

Chart E Non-financial corporations' margins

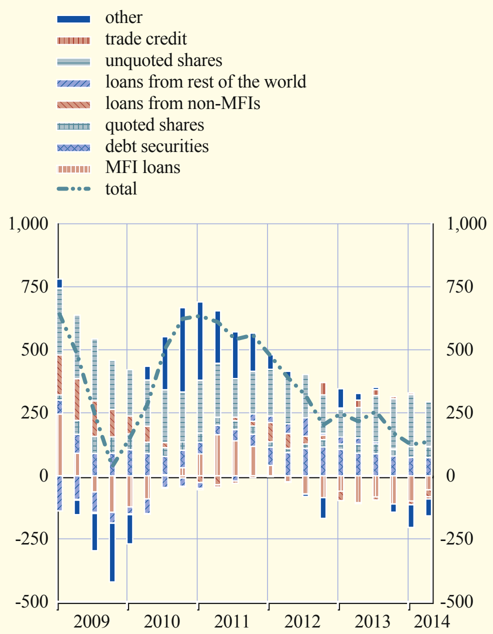
(percentages, four-quarter average)



Sources: Eurostat and ECB.

Chart F External financing of non-financial corporations

(in EUR billion; four-quarter sums)



Sources: Eurostat and ECB.
Notes: MFI loans and loans from non-MFIs (other financial intermediaries, and insurance corporations and pension funds) corrected for loan sales and securitisations. Other is the difference between the total and the instruments included in the chart.

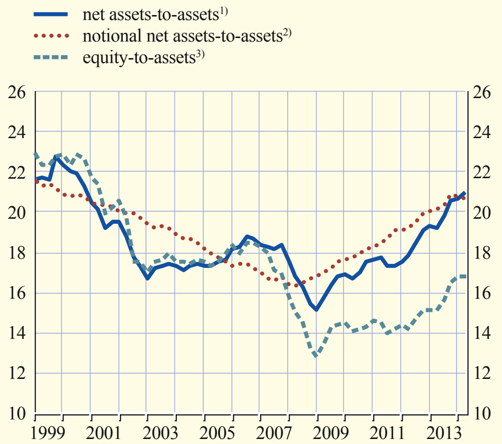
broadly unchanged at moderately positive levels. The moderation in retained earnings and lower inventories more or less offset the deceleration of gross fixed capital formation. NFCs' external financing increased slightly in the second quarter of 2014 (see Chart F), driven primarily by higher bank loans to firms. At the same time, net issuance of debt securities and quoted shares by NFCs remained at robust levels and was supported by lower corporate bond yields and favourable investor sentiment. Net issuance of unquoted shares and other equity, by contrast, was subdued for the second quarter in a row. This was partly due to foreign multinational firms continuing to transfer retained profits out of the euro area, which are initially recorded, by statistical convention, under this instrument in firms' balance sheets. Trade credit and inter-company lending remained weak. The weakness of intra-sectoral financing may be explained by firms using higher retained profits and deposit holdings to finance working capital in an environment of high uncertainty regarding the strength of the global and domestic economic recovery. Lending by foreign entities strengthened modestly further, in comparison with the previous quarter, indicating that firms continued to issue bonds indirectly via conduits resident outside the euro area in the context of high demand for euro area securities. At the same time, lending by non-MFIs remained weak. NFCs' liquidity buffers remained broadly unchanged at high levels (€2.7 trillion, which is around ¼ of annual nominal GDP). The leverage ratio stabilised after having declined by 3½ percentage points since mid-2013 (see Chart H). Underlying this stabilisation was a strengthening of debt financing that was compensated for by increased assets, originating mainly from the impact of further holding gains on total equity.

The *general government* sector's net borrowing declined (on a four-quarter-sum basis) from 2.7% in the first quarter to 2.6% in the second quarter. Excluding capital transfers to financial corporations, net borrowing was broadly unchanged. Both revenue and spending growth decelerated, year on year, in comparison with the first quarter. In the case of revenue, receipts from direct taxes payable by corporations were lower than a year earlier, as were most components of non-tax revenue. On the spending side, gross fixed capital formation was particularly weak (-2.1%, year on year). Government consumption growth remained unchanged (1.6%, year on year).

Gross entrepreneurial income of *financial corporations*, which had remained almost unchanged in the first quarter of the year, returned to the path of sustained decline, which had started in mid-2011, in the second quarter (annual growth of -6.0%). This decline reflected a slight moderation in value added – although this was still the only resource category recording positive growth (4.2%) – an improvement in compensation of employees (which declined by -0.2%, compared with -1.0% in the previous quarter) and a reduction in dividends received (-5.0%).

Chart G Capital ratios of financial institutions excluding mutual funds

(percentages of total assets)



Sources: Eurostat, ECB.
1) Assets and liabilities are valued at market value.
2) Calculated on the basis of cumulated transactions in net assets and assets, i.e. excluding holding gains/losses on assets and liabilities.
3) "Equity" comprises "shares and other equity" other than "mutual fund shares". Interbank deposits and Eurosystem financing are netted out from assets and liabilities.

Nonetheless, retained earnings grew strongly, at an annual rate of 20.6%, showing the first positive reading since the beginning of 2012. This development was due to a sharp decline in dividends paid (-18.7%), which represents a halt in the recent increasing trend towards a redistribution of profits to shareholders via dividends. The expansion of retained earnings, combined with large holding gains on assets, led to an increase in headline capital ratios. The higher retained earnings may partly reflect preparations for the completion of the AQR in the third quarter. At the same time, equity issuance continued to contribute negatively to the accumulation of capital buffers, partially reflecting disinvestment in financial conduits, which led to a slight decline in the transaction-based measure of the capital position (see Chart G). The stock market valuation of the sector remains significantly below the market value of net assets, reflecting continued market distrust. Financial corporations' financial investment (excluding inter-MFI deposits and loans) picked up slightly, but the annual growth rate remained below 1%.

Balance sheet dynamics

In relation to developments in indebtedness, gross debt-to-GDP ratios continued to increase in the case of both the government and the financial sector in the second quarter of 2014, from already high levels. NFCs' indebtedness also edged up from the previous quarter, after having declined continuously since mid-2012. Households' debt ratio remained unchanged. The picture is more favourable, however, when other leverage measures, such as debt-to-assets and net worth ratios, are considered. Debt-to-assets ratios (including financial and non-financial assets) in the private sector fell anew, albeit only marginally, in the case of all subsectors. Government sector leverage continued to rise. The international investment position (i.i.p.)[2] of the euro area showed a significant improvement in the second quarter of 2014, to -15.3% of GDP, after -18.1% in the previous quarter. This improvement mainly reflected the positive net lending position of the euro area and, to a somewhat lesser extent, valuation gains due to relative asset price and exchange rate changes.

The debt-to-assets ratio of NFCs stabilised at 45.1% in the second quarter of 2014, after having declined continuously, by 3½ percentage points, since mid-2013 (see Chart H). The debt-to-assets ratio is now 9 percentage points lower than at the peak reached in early 2009 (see Chart H). Underlying the recent stabilisation was

Chart H Sectoral leverage

(percentages of total assets)

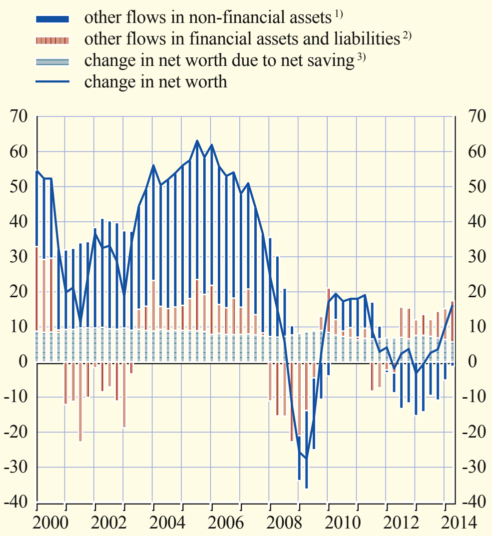
Sources: Eurostat and ECB.
Notes: Calculated as a ratio of total debt liabilities to total assets. Total assets comprise all financial assets and most non-financial assets.

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

a strengthening of debt financing that was compensated for by increased assets, originating mainly from the impact of further holding gains on total equity. The net worth of households continued to rebound, again increasing on a year-on-year basis (16.2% of their annual income) (see Chart I). This improvement reflected holding gains on households' financial portfolios (amounting to 11.7% of their income), which mirrored the observed increases in share and bond prices. Households' net savings also contributed positively to the increase in households' net worth (5.7% of their income). Together, the holding gains on financial assets and positive net savings exceeded moderating holding losses (-1.2% of their income) on non-financial (housing) assets by a considerable margin. Financial corporations' headline capital ratios increased again, to stand at relatively high levels (see Chart G). These increases could partly reflect supervisory requirements and preparations for the completion of the AQR in the third quarter.

Chart I Change in the net worth of households

(four-quarter 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.