Box 5

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

The integrated euro area accounts, released on 29 October 2013 and covering data up to the second quarter of 2013, offer comprehensive information on the income, spending, financing and portfolio decisions of institutional sectors in the euro area. The euro area external balance improved again, as a result of a further increase in the trade surplus. Household income continued to grow very slowly in nominal terms and declined significantly again in real terms (by 1.1% year on year). This caused households to reduce their saving flows, nudging their saving ratio back down to record lows, while housing investment fell further. Non-financial corporations (NFCs) remained in a net lending position (as opposed to their more usual net borrowing position), with fixed investment remaining close to historical lows as a share of value added and still

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

declining in year-on-year terms (albeit at a reduced pace). NFC business margins remained at very low levels, below their post-Lehman trough. The reduction of government deficits resumed. From a balance sheet perspective, household net wealth declined slightly, while the strong NFC deleveraging trend was interrupted in the second quarter owing to losses on equity held. Financial corporations' capital ratios remained stable at high levels. The international investment position (i.i.p.), which captures the net external balance sheet position of the euro area, improved further, while non-residents continued to shift from deposits into debt securities.

Euro area income and net lending/net borrowing

In the second quarter of 2013 the nominal growth rate of euro area disposable income recovered to 0.7% year on year, from 0.1% in the first quarter. This reflected the improvement in year-on-year real GDP growth from the first to the second quarter (which contributed 0.6 percentage point). There was also a reversal of the adverse working day effects that affected the first quarter (contributing around 0.7 percentage point). These effects were offset by a deterioration in net property income and transfers with the rest of the world (-0.7 percentage point). The rebound in euro area nominal income primarily reflected an increase in government income (see Chart A).

With euro area consumption growing at broadly the same rate as income, overall euro area gross saving growth came to a standstill. The household saving ratio fell back to its historical low and NFCs' retained earnings declined. By contrast, the government sector resumed the reduction in dissaving. The pace of decline in euro area fixed capital formation more than halved, standing at 3.2% year on year in the second quarter, reflecting a fall in all sectors: investment of NFCs contracted by 2.7%, while that of households and government fell by 2.8% and 1.6%

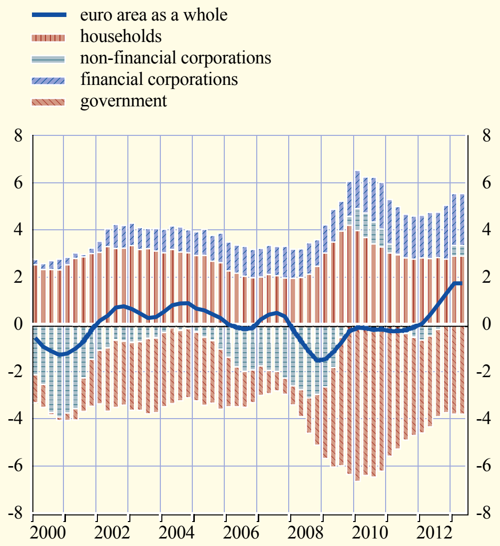
Chart A Gross disposable income in the euro area and contributions by sector

(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.

respectively. A slight destocking was observed in the second quarter, with the result that the pace of decline in gross capital formation was very close to that of fixed capital formation.

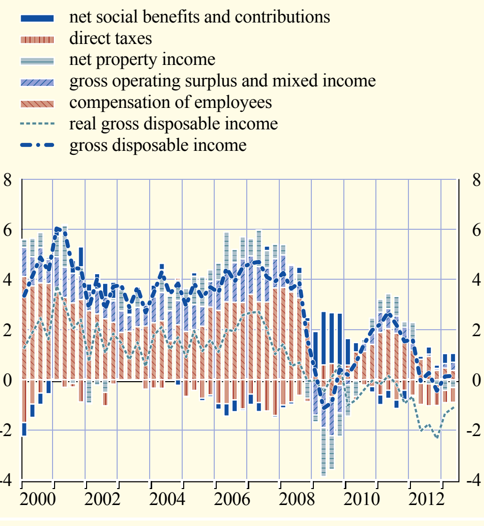
With capital formation still declining and savings stabilising, euro area "net lending" improved further, to stand at 2% of GDP on a four-quarter-sum basis. This is also reflected in the increase in the current account surplus. From a sectoral viewpoint, this improvement notably mirrored a reduction in government deficits and an increase in the net lending of financial corporations, while the net lending of NFCs and households remained broadly stable on a four-quarter-sum basis (see Chart A). On the financing side, cross-border flows remained subdued, with non-residents continuing to shift from deposits into debt securities. The i.i.p. improved further, standing at -18.7% of GDP in the second quarter.

Behaviour of institutional sectors

In the second quarter of 2013 *household* nominal income growth remained subdued (standing at 0.2% year on year). On the one hand, the fiscal drag (household net transfers vis-à-vis government) subtracted 0.2 percentage point from annual income growth, while net property income earned accounted for a further 0.3 percentage point reduction. On the other hand, compensation of employees continued to grow at a slow pace (0.5%), while gross operating surplus and mixed income accelerated somewhat (see Chart C). Amid lower inflation, real income fell less markedly in the second quarter, declining at a rate of 1.1% year on year (as compared with a low of 2.3% in the fourth quarter of 2012). As consumption grew at a somewhat faster rate (0.5% in nominal terms), households' savings contracted, pushing the saving ratio back to its record low of 12.8% on a seasonally adjusted basis (see Chart D). The pace of contraction in housing investment halved but still remained significant. Household net lending thus remained

Chart C Households' nominal gross disposable income

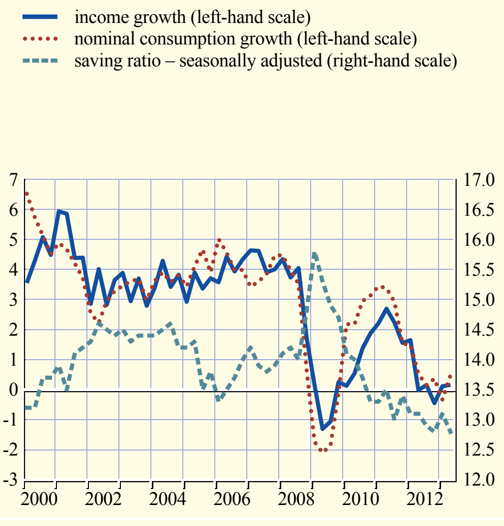
(annual percentage changes; percentage point contributions)



Sources: Eurostat and ECB.

Chart D Households' income, consumption and saving ratio

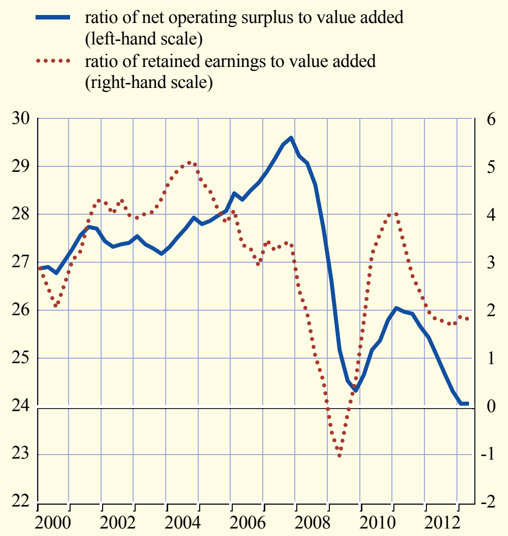
(annual percentage changes; percentage of gross disposable income, seasonally adjusted)



Sources: Eurostat and ECB.

Chart E Non-financial corporations' margins

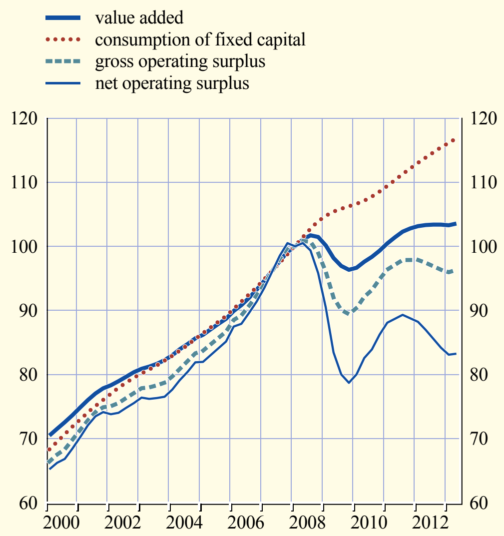
(percentages, four-quarter moving averages)



Sources: Eurostat and ECB.

Chart F Non-financial corporations' value added, operating surplus and consumption of fixed capital

(index: Q1 2008=100)



Sources: Eurostat and ECB.

broadly stable. Growth in both household financing and financial investment stabilised at very low levels. On the financing side, borrowing from banks came to a halt. On the assets side, households continued to shift their portfolios into bank deposits, insurance technical reserves and mutual funds, and away from debt securities. Household net wealth fell somewhat year on year, as holding losses on housing again exceeded net saving and year-on-year gains on equity held (see Chart G). As a consequence, households' leverage ratio continued to edge up.

The gross operating surplus of *NFCs* picked up in the second quarter of 2013 after having declined in the first quarter, as value added recovered (growing at a rate of 1% year on year) and outpaced the stable slow growth in wages. Business margins, as measured by the ratio of net operating surplus to value added, remained at the low point reached in the first quarter, which was even lower than the post-Lehman trough (four-quarter average; see Chart E). When measuring firms' profitability using national accounts, the focus should be on the net operating surplus rather than the gross operating surplus since consumption of fixed capital (i.e. amortisation of capital equipment and buildings spread 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 net profit measure tends to be more sensitive to the business cycle than a measure of gross profits and is thus likely to be more depressed during periods of low activity (see Chart F).[2] At the same time, a number of factors continued to keep NFC net savings (i.e. retained earnings) at relatively elevated levels, notwithstanding a decline in the second quarter: net interest paid by NFCs remained low (and continued to fall), as did net dividends paid out (although they increased). The overall pace of decline in fixed capital expenditure moderated to -2.7% year on year, from -8.3% in the first quarter, while investment remained close to its historical low as a share of value added. The unusual net lending position

2 See, for instance, the box entitled "The role of profits in shaping domestic price pressures in the euro area", *Monthly Bulletin*, ECB, March 2013.

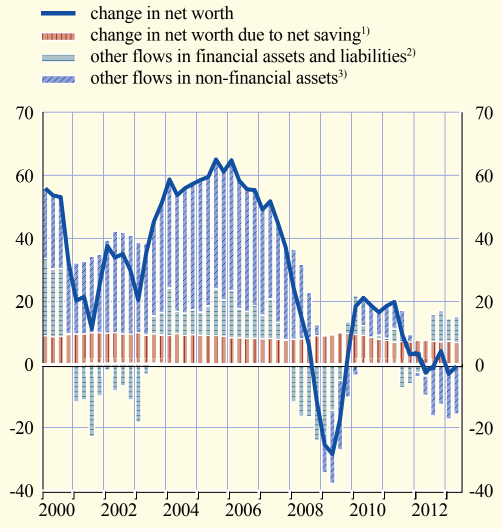
of NFCs declined somewhat in the second quarter (though still increasing year on year). On the financing side, in order to compensate for bank lending (which contracted by €150 billion over four quarters), NFCs continued to tap the bond market (€92 billion in net terms) and the stock market (€21 billion), as well as to actively borrow from other financial corporations (€99 billion). Intra-sector lending, comprising loans granted by other NFCs and the bulk of trade credits (which are important for SMEs facing bank financing constraints), came to a halt. NFCs reduced the pace at which they increased their already ample liquidity buffers (which stood at €2.7 trillion). The ongoing deleveraging process of NFCs was temporarily interrupted in the second quarter owing to the lower valuation of equity held.

The reduction of the *government* deficit resumed (with net borrowing standing at 3.7% of GDP on a four-quarter-sum basis), despite significant capital expenditure related to bank recapitalisation (0.7% of GDP on a four-quarter-sum basis), owing mainly to the reversal of the abrupt deceleration in tax revenue observed in the first quarter. Current expenditure grew by 1.7% year on year in nominal terms in the second quarter. Fixed investment expenditure fell again, but at a slower pace. Debt issuance continued to fund large deficits as well as significant increases in financial assets, with the latter notably reflecting sizeable intergovernmental lending and some frontloading of debt issuance. Debt securities issued were bought by financial corporations, particularly banks, and to some extent by non-residents.

The year-on-year fall in the disposable income of *financial corporations* moderated. Net dividends earned stabilised, while value added and net interest earned, taken together, continued

Chart G Change in the net worth of households

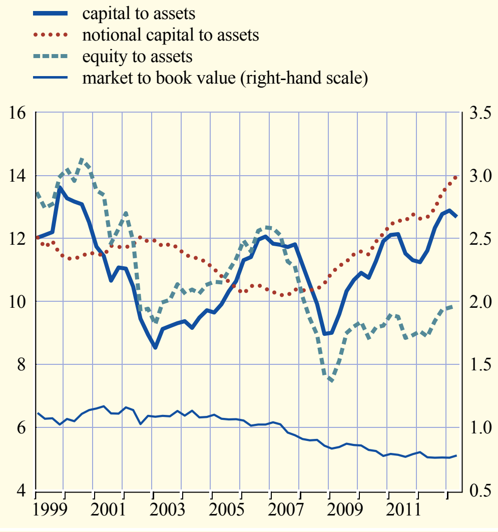
(four-quarter moving sums; percentages of gross disposable income)



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

Chart H Capital ratios of financial institutions excluding mutual funds

(percentage of total assets; ratio)



Source: ECB.
Notes: In this chart, "equity" comprises "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.

to contract, and higher taxes were paid. Financial corporations' net assets at market value (an aggregate measure of "capital" using national accounts data) remained broadly stable, despite sizeable net retained earnings (€47 billion in the second quarter), significant capital transfers received from government (€14 billion), and equity raised on the market (€38 billion). Financial corporations' net assets at market value suffered from holding losses on their asset portfolios, notably in debt securities. On the positive side, however, the "notional" value of this capital ratio (which eliminates the impact of holding gains and losses) continued to increase rapidly (see Chart H). The discount of the stock market value of financial corporations to their net assets at market value (shown as the "market to book value" in Chart H) remained very large, reflecting continued market distrust. Additions to financial corporations' balance sheets remained subdued on a consolidated basis.

Balance sheet dynamics

All in all, the net wealth of households fell slightly, year on year, in the second quarter, by the equivalent of 0.5% of income. The positive influence of net saving (7.0% of income) and of holding gains on their financial portfolios (8.3% of income, cumulated over one year) was more than offset by significant holding losses on non-financial assets (i.e. housing, amounting to 15.7% of income) (see Chart G).

Financial corporations posted significant holding losses on their portfolio of assets in the second quarter. This was mostly due to a decline in the value of debt securities, as market yields increased, and to a lesser extent of equity held (quoted shares, unquoted shares and mutual funds). These holding losses offset sizeable capital increases, with the result that the capital ratio as measured by net assets at market value remained stable (see Chart H).