

Corporate and Household Sectors in Austria: Subdued Growth of Indebtedness

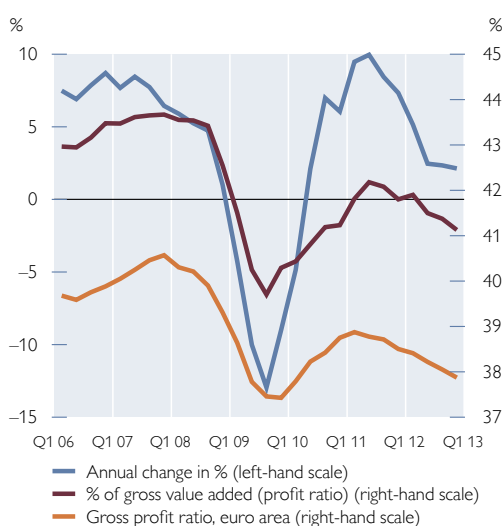
Stabilization of Corporate Sector Risk Indicators

The Austrian Economy Slows Down

Against the background of the renewed recession in the euro area, the Austrian economy performed comparatively well. Nevertheless, Austria was not able to avoid being affected by European developments and has been facing stagnation since the second quarter of 2012. In its June 2013 outlook, the OeNB expects Austrian real GDP to expand by 0.3% in 2013 and by 1.5% in 2014. The euro area crisis has exerted a drag on Austrian exports, especially goods exports into the euro area. The decline in exports was spurred above all by the recession in key export destinations. Persistent uncertainty about future sales prospects dampened gross fixed capital formation, which is particularly sensitive to cyclical developments. This holds in particular for equipment investment, while growth in housing investment remained in positive territory. Private consumption has stagnated in recent years, as the growth of Austrian households' real disposable income is subdued. As a consequence, domestic demand has not been able to sufficiently offset weak exports recently.

After surging in 2011, corporate profitability abated in 2012, reflecting the economic slowdown (see chart 7). Corporate earnings were fostered by falling raw material prices, whereas wage developments had a dampening impact on corporate profitability in 2012. Gross operating surplus was up 2.1% year on year in nominal terms but flat in real terms. In addition, the non-operational component of corporate profitability was boosted by the low

Chart 7
Gross Operating Surplus of Nonfinancial Corporations



Source: Statistics Austria.

Four quarters of stagnation

interest rate level. While gross operating surplus had surpassed pre-crisis levels in nominal terms already in 2011, it has still failed to reach its pre-crisis highs in real terms as well as in relation to gross value added of the corporate sector (i.e. the gross profit ratio). The gross profit ratio even fell slightly to 41.1% in 2012. However, it was still markedly higher than the comparative value for the whole euro area.

Profit growth stalls in real terms

Further Reduction in External Financing of the Corporate Sector

According to the financial accounts, the volume of external financing amounted to EUR 10.8 billion¹ in 2012, which was less than half the – extraordinarily high – 2011 figure. This slowdown might partly reflect high internal financing owing to still growing profits and partly lower financing needs due to

¹ Adjusted for foreign-controlled holdings in special purpose entities.

Tighter credit standards

reduced investment. Both debt and equity financing slowed down markedly in 2012. Debt financing, which was almost 50% lower than in the previous year, contributed almost two-thirds of the – strongly diminished – external financing, with the remaining one-third stemming from equity financing, which fell to one-third of the 2011 value.

Rising Contribution of Bank Loans to Corporate Financing**Bank lending loses momentum**

Lending by domestic banks accounted for around 30% of external financing of nonfinancial corporations in 2012, more than twice the comparable 2011 figure. However, in the second half of 2012, the growth of bank loans to the corporate sector in Austria lost momentum. According to the MFI balance sheet statistics, the annual rate of change in Austrian bank lending to nonfinancial corporations (adjusted for reclassifications, valuation changes and exchange rate effects) fell from 2.7% in nominal terms in September 2012 to 0.8% in April 2013 (see chart 8). Deflated with the GDP deflator,² corporate loans shrank by almost 2% year on year in real terms in the first quarter of 2013.³ This slowing was mainly driven by lending at longer maturities (more than five years) on which loan growth had rested in the past years, while loans with a maturity of less than five years stabilized in the first months of 2013. Despite this deceleration, the Austrian corporate sector could escape the slowdown witnessed in the euro area as a whole, where the nominal growth rate has been negative since the first half of 2012.

Lending rates decrease

The slowdown was driven by both supply- and demand-side factors. Credit standards for corporate loans had been tightened slightly but continuously by the Austrian banks since the second half of 2011, according to the Austrian results of the euro area bank lending survey (BLS). The more stringent lending policies affected large firms more than small and medium-sized enterprises (SMEs). Costs related to banks' capital position as well as heightened risk concerns reflecting the economic slowdown were behind this tightening. At the same time, the banks surveyed in the BLS noted a slight decline in corporate loan demand, again primarily from large companies. This can be explained by lower funding requirements for fixed investment on the one hand; on the other, companies still relied to a considerable extent on internal sources of finance and had sizeable amounts of cash to finance their activities: Bank deposits expanded vigorously in 2012, although their growth slowed down to 1.7% year on year in April 2013.

Up to now, tighter credit standards have resulted not primarily in higher loan volumes but rather in tighter terms and conditions. Stronger risk discrimination by banks has found its expression not only in higher margins on riskier loans, but also in rising collateral requirements as well as more, or stricter, covenants, whereas a deterioration in banks' financing conditions is reflected in the tightening of the size and maturity of loans granted to enterprises.

In part, the net tightening of banks' lending terms and conditions dampened

² Based on the deflator for the fourth quarter of 2012, as the value for the first quarter of 2013 was unavailable at the cutoff date.

³ At the cutoff date, financial accounts data were available up to the fourth quarter of 2012. Therefore, the figures on growth contribution presented here refer to 2012. More recent developments of financing flows are discussed using data from the MFI balance sheet statistics and the securities issues statistics.

the reduction of financing costs stemming from monetary policy easing. In response to the three ECB interest rate cuts of November 2011, December 2011 and July 2012 (by 0.25 percentage points each) and the associated decline in money market rates, corporate lending rates declined by 91 basis points between December 2011 and March 2013.⁴ While interest rates fell for all loan volumes and maturities, this decrease was slightly more pronounced for short-term loans and for larger loans (with a volume of more than EUR 1 million) than for smaller ones.

On top of borrowing from domestic banks (EUR 3.7 billion), Austrian enterprises took out another EUR 1.0 billion from foreign banks in 2012. Taken together, Austrian and foreign bank lending accounted for about 43% of last year's corporate external financing.

Bond Financing Remained Vigorous

According to securities issues statistics, bond issues by Austrian nonfinancial corporations increased by more than one-quarter to EUR 4.8 billion in 2012. This was equivalent to 45% of Austrian companies' external financing of that year, considerably above the average of the previous years. Thus, net new bond issuance was again higher than the total volume of new bank lending (from domestic and foreign banks) in 2012 and remained strong in the further course of the year. At an annual rate of 9.6% (according to the securities issues statistics), the expansion of corporate bonds in April 2013 markedly exceeded that of other financing instruments. While this development may be viewed as a broadening of the corporate sector's financing sources, this funding option

is available only to a limited number of mostly larger companies. Moreover, a considerable part of corporate bonds in Austria is issued by corporations that are majority-owned by the public sector.

The share of variable rate bonds declined slightly in 2012, falling from 13.7% at the end of 2011 to 12.9% in March 2013, while the share of bonds issued in foreign currency fell from 9.7% to 7.2%.

Bond yields, like bank lending rates, contracted in 2012 and the first months of 2013. Their decline was even more pronounced than that of lending rates. Reflecting the increase in investors' risk appetite, yields on BBB-rated bonds dropped by 416 basis points to 3.14% between the end of 2011 and May 2013.⁵ In the same period, yields on AA-rated corporate bonds declined by 223 basis points, so that the yield spread between BBB issues and top-rated euro-denominated corporate bonds narrowed from 316 to 122 basis points, the lowest value recorded since April 2011. Taking a longer perspective, BBB bond yields were about 8½ percentage points below the peak values observed at the height of the financial market turmoil in spring 2009 and about 250 basis points lower than in July 2007, before the financial crisis set in.

Lower Recourse to Trade Credit

Trade credit accounts for a fairly large part of firms' funding sources; it contributed more than 5% to outstanding financial liabilities at the end of last year. In 2012, the net volume of trade credit by domestic companies decreased by more than two-thirds compared to 2011. As a key element of firms' working

Bonds account for almost half of external financing

Trade credit declines

⁴ The ECB interest rate cut of May 2013 is not yet reflected in the available interest rate data.

⁵ Euro area figures are used here, as no time series is available for yields on Austrian corporate bonds.

capital, trade credit closely depends on economic activity while at the same time – given its relatively informal form and comparatively high cost – increased recourse to trade finance might be correlated with financial distress, possibly along with restricted access to other forms of finance. Thus, the low use of trade credit may also be an indi-

cation that while bank credit standards were tightened in 2012, they were not so restrictive as to drive firms into alternative sources of finance.

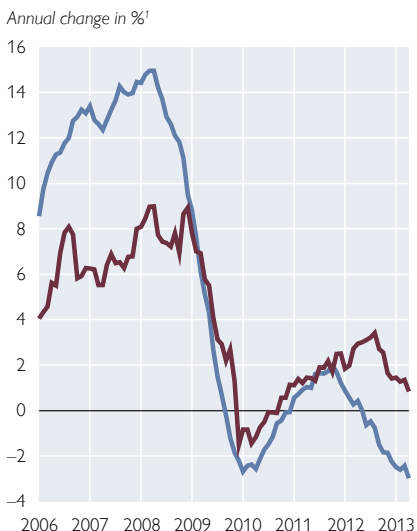
Equity Position Increased Slightly

Almost 40% of the external financing of nonfinancial corporations came in the form of equity. Relative to the corporate

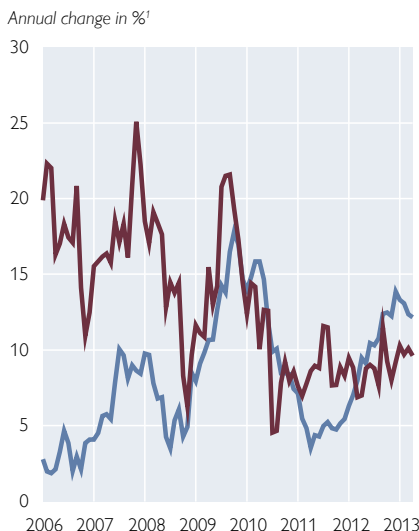
Chart 8

Key Elements of Nonfinancial Corporations' Financing: Volumes and Conditions

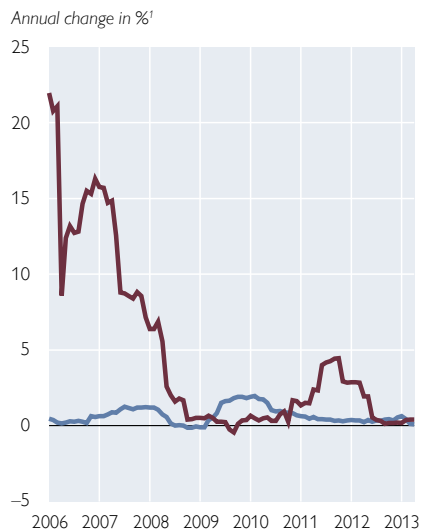
Loans: Volumes



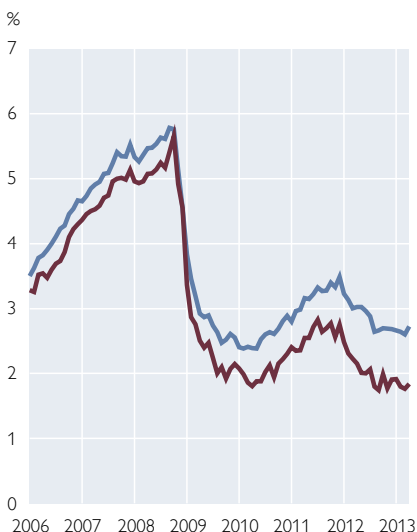
Bonds: Volumes



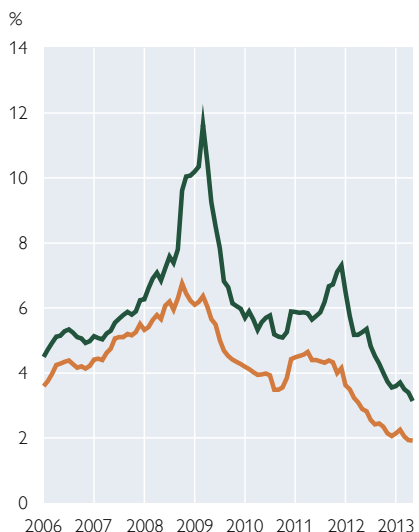
Quoted Stocks: Volumes



Loans: Interest Rates



Bonds: Yields



Quoted Stocks: Earnings Yield



— Austria — Euro area — AA — BBB

Source: OeNB, ECB, Thomson Reuters, Wiener Börse AG.

¹ Adjusted for reclassifications, changes in valuation and exchange rate effects.

sector's total liabilities, its equity position (i.e. the proportion of shares in total liabilities) rose slightly from 42.7% to 43.0% in 2012.

Financing via listed stocks continued to be affected by the crisis and accounted for just 2% of external financing in 2012. There were no new listings in 2012, and only one new listing in 2013 up to the cutoff date for data. Additionally, there were a few capital increases. Including a few small delistings, the net issuance of capital on the stock exchange amounted to EUR 0.2 billion in 2012. Another EUR 0.1 billion was issued in the first four months of 2013, according to securities issues statistics. Other equity (unquoted shares and other equity instruments), mostly from foreign strategic investors, also decreased in 2012 (to EUR 2.9 billion).

The earnings yield (i.e. the inverse of the price-to-earnings ratio) of the ATX, which can be used as an indicator of the cost of raising capital on the Austrian stock market, dropped from 11.6% in December 2011 to 6.5 in May 2013. But as there were virtually no new issues in 2012 and 2013, this was a purely notional figure.

Companies' Debt Servicing Capacity Is Stable

Mirroring the reduction in external financing, the annual expansion rate of corporate debt (in terms of total loans and bonds) decelerated further to 2.3% in 2012. In net terms, enterprises substituted short-term for long-term funding. The growth of long-term financing instruments, which account for more than 80% of outstanding debt, decreased while short-term financing even diminished in absolute terms. However, although the growth rate of corporate debt was well below the long-term average, it was slightly ahead of the subdued earnings growth rate so that the

ratio of corporate debt to gross operating surplus rose slightly – by less than 1 percentage point – to 485%, implying a virtually unchanged sustainability of corporate debt (see chart 9). Hence, the ratio of corporate debt to gross operating surplus remained above its pre-crisis levels. It was lower than in the euro area, however. As debt growth remained somewhat below the increase of equity financing, the debt-to-equity ratio came down slightly in 2012 to reach 117% at the end of 2012. Contrary to the debt-to-income ratio, the debt-to-equity ratio is considerably higher in Austria than in the euro area, which highlights the importance of debt financing in Austria.

Low interest rates continued to support firms' ability to service their debt. In 2012, the fraction of corporate earnings (gross operating surplus) that had to be spent on interest payments for bank loans declined further. This decline was bolstered by the above-average share of variable rate loans in Austria. For this reason, Austrian companies currently have lower interest expenses than their euro area peers, but at the same time their exposure to interest rate risk is considerably higher. Thus, even though corporate sector debt – and thus the sector's exposure to interest rate risk – increased only moderately in the past two years, a rise in interest rates might create a noticeable burden, especially for highly indebted companies.

The share of foreign currency loans declined by roughly two percentage points to 6.5% over the past year, and thus was only less than 2 percentage points higher than in the euro area at the end of 2012.

The number of corporate insolvencies, which had increased relatively little during the crisis, remained small until the first quarter of 2013. In the

Stock market financing remains affected by the crisis

Variable rate loans imply interest rate risk

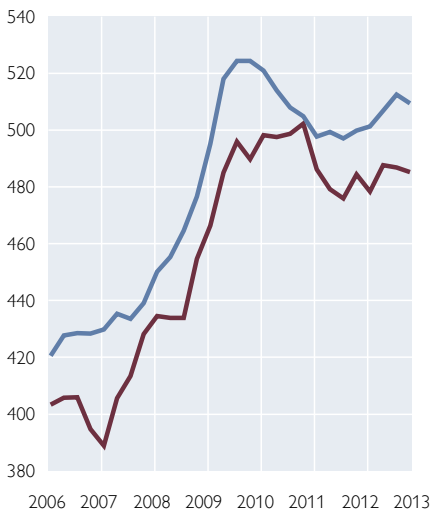
Debt ratio increases slightly

Insolvencies remain low

Risk Indicators for Nonfinancial Corporations

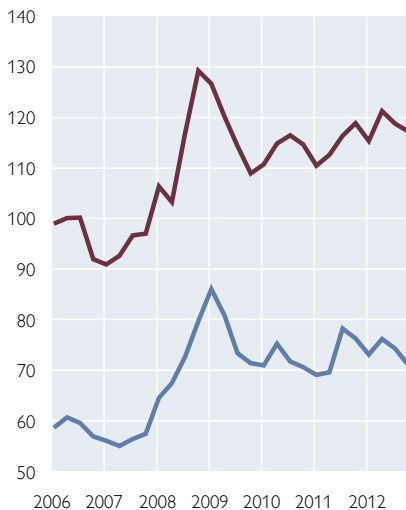
Debt

% of gross operating surplus



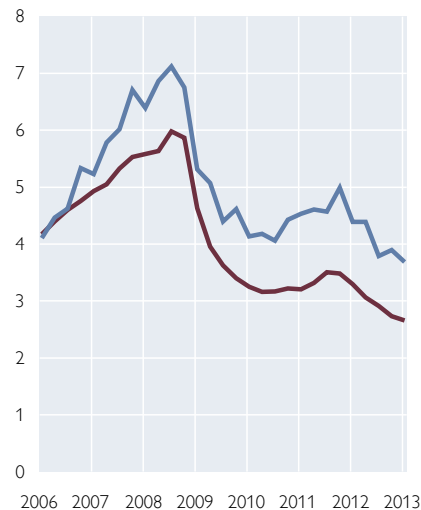
Debt-to-Equity Ratio

%



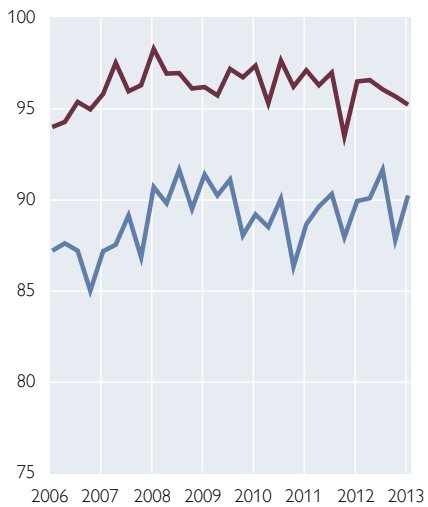
Interest Expenses

% of gross operating surplus



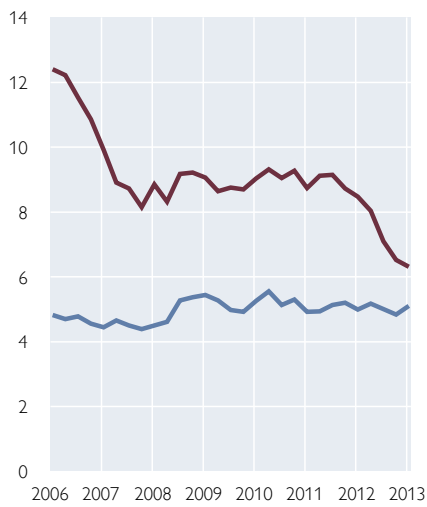
Variable Rate Loans

% of total new lending



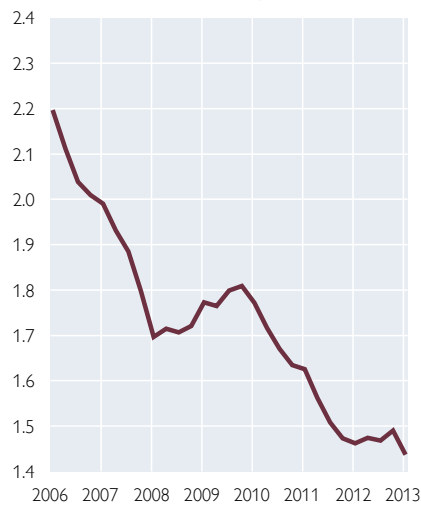
Foreign Currency Loans

% of total loans



Insolvencies

Number of insolvencies in % of companies



— Austria — Euro area

Source: OeNB, ECB, Eurostat, KSV 1870.

first quarter of 2013, it was 0.2% lower than the comparable 2012 figure (based on a moving four-quarter sum to account for seasonality); it also dropped markedly in relation to the number of existing companies. On the one hand, this development may be due to the rather slow rise in debt financing and the low interest rate level (which makes debt servicing easier even for highly indebted

companies). On the other hand, it can also be attributed to the fact that insolvencies usually lag cyclical movements.

Households' Foreign Currency Debt Remains a Concern Low Growth of Real Income

In 2012, households' real disposable household income grew by a mere 0.7% in real terms. Despite relatively high

wage settlements and strong employment growth, quarter-on-quarter growth was even negative in the second and third quarters. High inflation and negative wage drift resulting from an increase in part-time jobs and a structural shift to low-wage jobs acted as a drag on incomes. Moreover, the saving ratio increased from 7.4% in 2011 to 7.7% in 2012. The low interest rate environment may have reduced the attractiveness of saving and property income – the portion of disposable income people are more likely to save than labor income – developed better than in the preceding years.

Household Financial Investment Increases for the First Time since the Beginning of the Crisis

After having fallen for four consecutive years, financial investment by households⁶ rebounded slightly in 2012, and,

at EUR 9.3 billion, was 5.9% higher than in 2011 (see chart 10). However, it was still only half as high as the pre-crisis peak value recorded in 2007.

At EUR 3.7 billion, investment in bank deposits was almost 15% lower than in 2011; it accounted for 40% of financial investment in 2012. Large inflows into overnight deposits were recorded, whereas the volume of deposits with longer maturities declined in absolute terms in 2012. Broken down by types of deposit, demand and time deposits grew while savings accounts registered a net decrease, even including capitalized interest. Deposits at building and loan associations represented the only exception: They augmented by 3.6% in 2012 on the back of the comparatively attractive interest rates for building loan contracts. The ongoing shift in the maturity structure suggests that households have a high preference

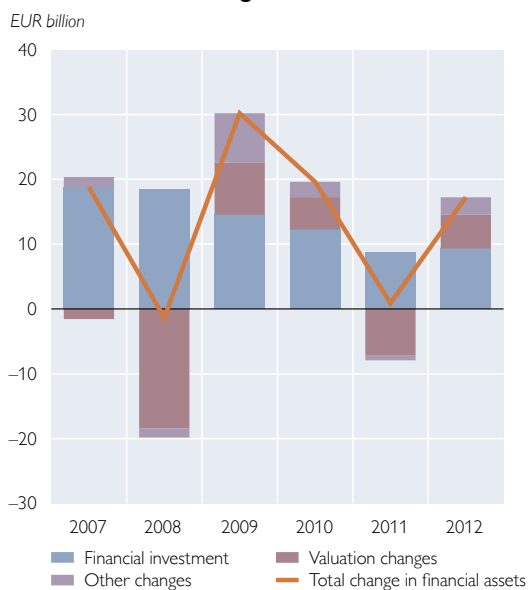
Slow deposit growth

Saving ratio still low

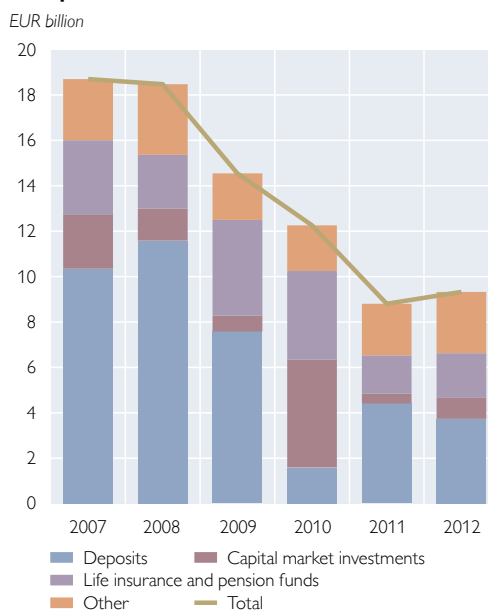
Chart 10

Changes in Households' Financial Assets

Determinants of Changes of Financial Assets



Components of Financial Investment



Source: OeNB.

⁶ Nonprofit institutions serving households are not included here.

for liquidity and may also be connected to moderate opportunity cost resulting from low interest rates.

Capital market investment turns positive in 2012

About 10% of households' financial investment went into capital market assets in 2012. Amounting to EUR 0.9 billion, it was twice as high as in 2011. This renewed interest in capital market investment reflected both the low interest paid on deposits as well as the recovery of share prices in the course of 2012. Austrian households increased their holdings of mutual fund shares as well as debt securities while there was a slight net outflow of direct holdings of equities.

Life insurance investment has a stabilizing effect

As in the preceding years, investment in life insurance and pension funds had a stabilizing effect on financial investment in 2012. Attracting net investments of EUR 2.5 billion, holdings of these investment instruments were roughly one-quarter higher than last year and accounted for around 27% of total financial investment in 2012. A large share of inflows into these instruments was not the result of current investment decisions, but – given the long maturities and commitment periods – reflected past decisions. Demand for funded pension instruments is a key factor in this context. Moreover, life insurance policies are often used as repayment vehicles for foreign currency bullet loans.

Foreign currency loans decline further

After the substantial (unrealized) valuation losses in their securities portfolios in 2011, Austrian households registered (equally unrealized) valuation gains in 2012. Coming to EUR 5.2 billion, these gains were equivalent to 5.5% of their securities holdings. Quoted stocks, debt securities and

Considerable unrealized valuation gains

mutual fund shares in the portfolios of Austrian households all registered (unrealized) valuation gains of roughly the same dimension. Taking financial investment, valuation gains and other changes together, financial assets rose by EUR 17.2 billion in 2012.

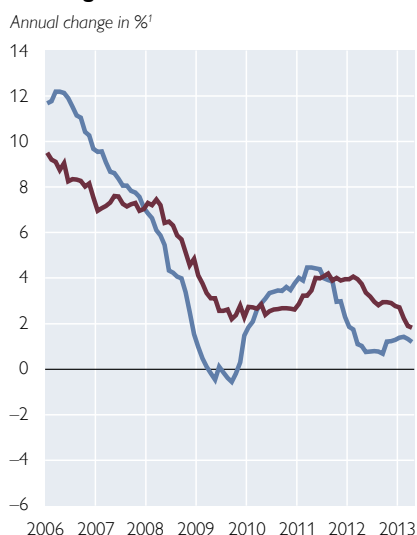
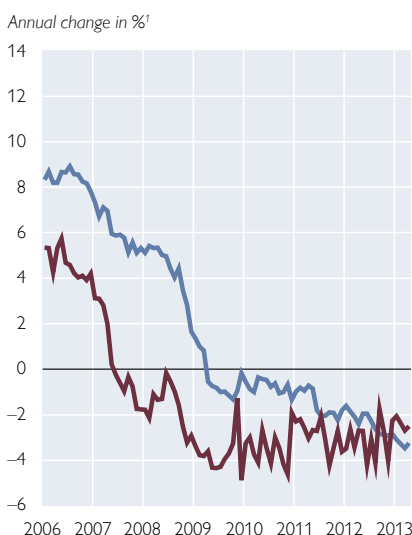
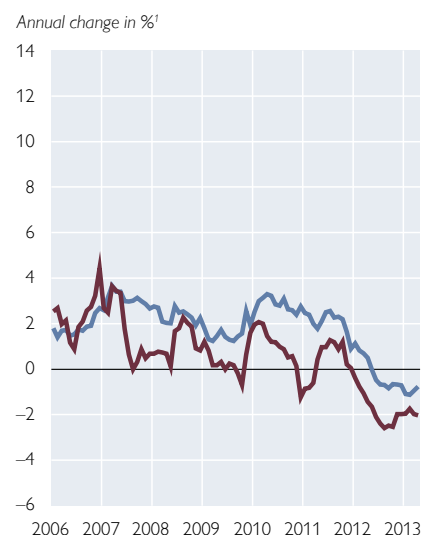
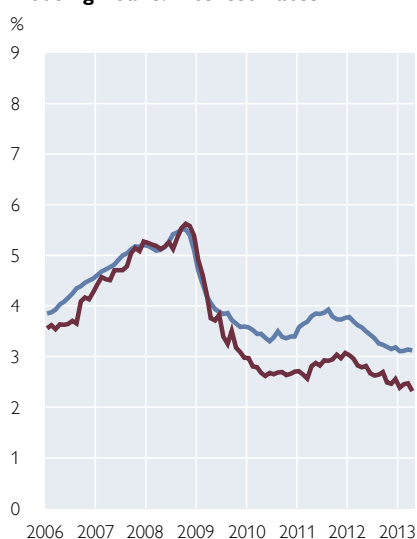
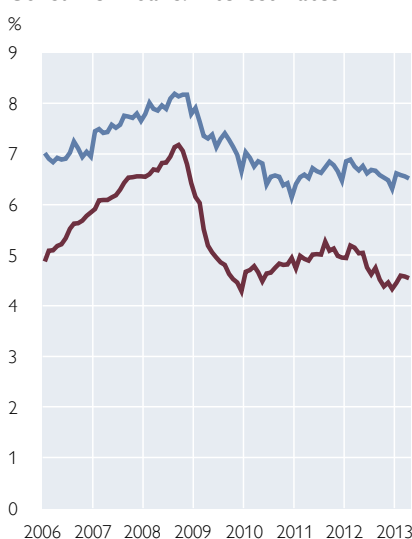
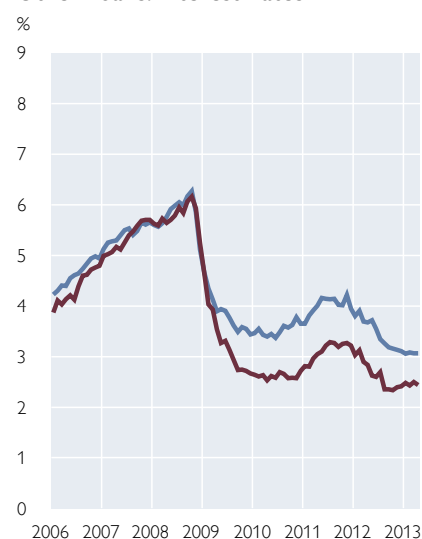
Subdued Lending Growth in the First Four Months of 2013

Growth of bank lending to households was subdued in the first months of 2013. As can be seen in chart 11, for almost two years, annual growth rates contracted continually and in April 2013, bank loans to households (adjusted for reclassifications, valuation changes and exchange rate effects) increased by a mere 0.2% in nominal terms, implying a considerable fall in real terms.

A breakdown by currencies shows that euro-denominated loans continued to expand unabatedly (April 2013: 6.4%), while foreign currency loans were cut markedly – in April 2013, they had fallen by 16.3% year on year. This considerable reduction highlights the effectiveness of the Austrian Financial Market Authority's minimum standards for granting and managing foreign currency loans, which aim at substantially limiting new foreign currency lending to households.⁷

Broken down by loan purpose, the slowdown in loan growth was mainly driven by a decline in consumer loans (–2.5% in April 2013 against the previous year) and other loans (–2.0%). Housing loans still grew by 1.8% year-on-year, although their expansion rate also decreased in the course of 2012 and 2013. The favorable financing

⁷ In January 2013, the Austrian Financial Market Authority (FMA) published a new version of its *Minimum Standards for the Risk Management and Granting of Foreign Currency Loans and Loans with Repayment Vehicles*. Prepared in cooperation with the OeNB, the new version specifies more stringent guidelines for dealing with foreign currency loans (see also the section "Slight Credit Growth in Austria, Increased Local Funding in CESEE").

MFI Loans to Households: Volumes and Conditions**Housing Loans: Volumes****Consumer Loans: Volumes****Other Loans: Volumes****Housing Loans: Interest Rates****Consumer Loans: Interest Rates****Other Loans: Interest Rates**

— Austria — Euro area

Source: OeNB, ECB.

¹ Adjusted for reclassifications, valuation changes and exchange rate effects.

conditions probably still supported the dynamics of housing loans, and households might have needed more funding to purchase real estate, as housing prices have been on the rise in Austria (+16% year on year in Vienna and +11% in Austria excluding Vienna in 2012). Other housing market indicators, however, pointed to a downturn in credit demand.

Although no current data on newly completed housing projects are available, the falling number of residential building permits (−8.4% year on year in the first three quarters of 2012) suggests a reduction in construction activity.

Loan conditions remained favorable. Interest rates for short-term loans (up to one year) stood at 2.73% in April

Financing conditions remain favorable

Household debt rises moderately

2013, 0.81 percentage points below their October 2011 level, reflecting the key interest rate cuts of November 2011, December 2011 and July 2012 (the available data do not reflect the May 2013 rate cut yet) and the associated decline in money market rates. Looking at data across the entire maturity band, interest rates on new housing loans stood at 2.31% in April 2013, which was 0.72 percentage points lower than the value recorded in October 2011. In the same period, interest rates on consumer loans dropped by 0.59 percentage points to 4.55%. As a result, interest rates were 2.9 percent-

age points (housing loans) and 2.7 percentage points (consumer loans) below their pre-crisis levels.

Households' Currency and Interest Rate Risks

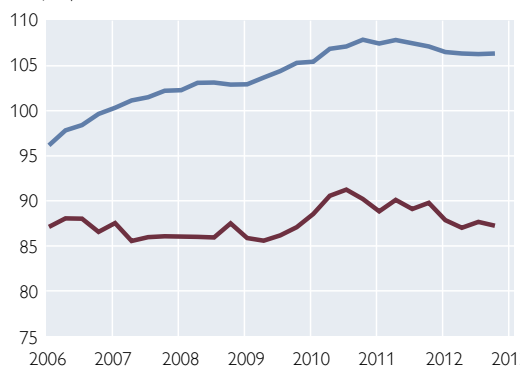
By international comparison, indebtedness of Austrian households is rather low and remained relatively stable during the crisis. At end-2012, total household liabilities stood at EUR 168.6 billion according to financial accounts data, up by a mere 0.6% in nominal terms from a year earlier. As a percentage of net disposable income, household debt amounted to 87.2%

Chart 12

Household Risk Indicators

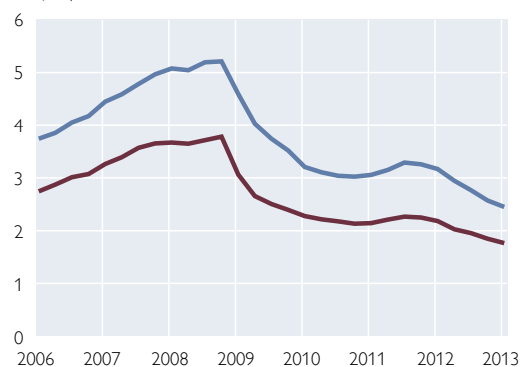
Liabilities

% of disposable income



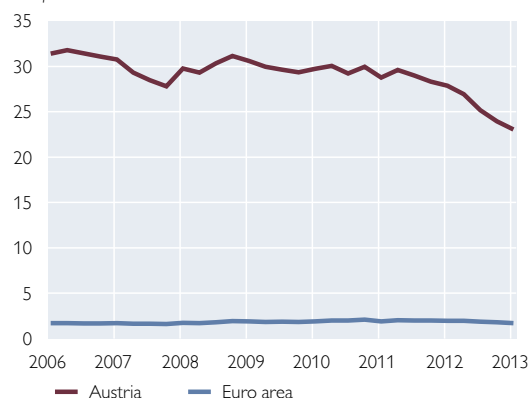
Interest Expenses

% of disposable income



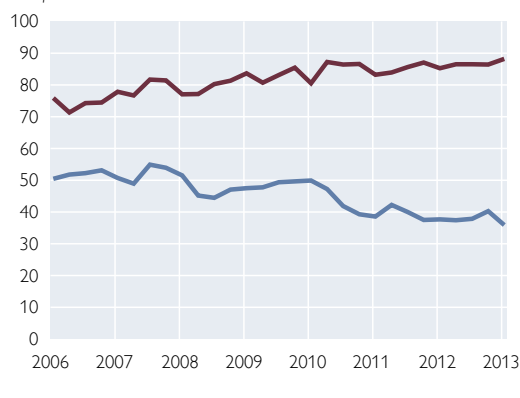
Foreign Currency Loans

% of total loans



Variable Rate Loans

% of total new loans



Source: OeNB, Statistics Austria, ECB, Eurostat.

Note: Figures for the euro area represent only the interest rate expense on euro-denominated loans.

(−2.5 percentage points from end-2011; see chart 12). The debt ratio of households in Austria thus continued to be lower than in the euro area as a whole (106% in the fourth quarter of 2012).

Given the combination of moderate debt growth and low interest rates, household interest expenses remained subdued and even declined again somewhat in 2012 and the first quarter of 2013 on the back of the reduction of interest rates for bank loans. Interest expenses amounted to 1.8% of disposable income in the first quarter of 2013, about 2 percentage points less than in 2008, before interest rates began to fall. One factor that accelerated this decline was the high share of variable rate loans: In the first quarter of 2013, 88.2% of new loans were granted with an initial rate fixation period of up to one year, which is a very high share by international comparison. Therefore, when the ECB lowered its key interest rates during the crisis, lending rates in Austria were reduced at a faster rate

than those in the euro area; in addition, retail rates in Austria have generally been below euro area rates in recent years. Moreover, loan quality may have also played a role, given the comparatively modest indebtedness of Austrian households.

Another risk factor for the financial position of Austrian households is the sustained high proportion of foreign currency loans in total loans. In the first quarter of 2013, 23.0% of the total loan volume to Austrian households was still denominated in foreign currency. This ratio has fallen by roughly 8 percentage points since 2008. The appreciation of the Swiss franc came to a halt in September 2011, when the Swiss National Bank set a maximum exchange rate of CHF 1.20 to the euro. However, as was shown in a recent study for this publication,⁸ households with foreign currency debt on average have higher income and housing wealth and are thus endowed with a higher risk buffer.

Share of foreign
currency loans falls
rapidly

Interest expenses
decrease further

⁸ Albacete, N., P. Fessler and M. Schürz. 2012b. *Risk Buffer Profiles of Foreign Currency Mortgage Holders*. Financial Stability Report 23, OeNB 2012.