

Corporate and household sectors in Austria: mounting vulnerabilities in the wake of the crisis

Austrian nonfinancial corporations' profits stalled in 2019

The Austrian economy was already slowing when COVID-19 hit. In a weakening international environment, economic growth in Austria had decelerated in 2019, with the decline being most pronounced in the export-oriented sectors of the economy. Against this backdrop, nonfinancial corporations became increasingly cautious about their investments. The measures to contain the spread of COVID-19 heavily affected the economy, leading to a sudden interruption of activity in large parts of the economy and throwing the Austrian economy into a severe recession. As a result, vulnerabilities in the corporate sector have increased considerably.

Amidst the slowdown of economic growth, corporate profitability weakened in 2019. In the final quarter, the gross operating surplus¹ of Austrian nonfinancial corporations decreased by 1.4% year on year in real terms (based on four-quarter moving sums), the first drop in six years. Profitability had already been on a downward trend for the past two years. In the fourth quarter of 2019, the gross profit ratio amounted to 41.2%, down 1.3 percentage points against one year earlier. Profitability had not yet returned to the levels seen before the global financial crisis. The slowdown in operating income also affected internal financing, the most important source of funds for Austrian nonfinancial corporations. Measured as the sum of changes in net worth and depreciation, internal financing remained virtually unchanged in 2019 against the high levels registered in the three previous years, amounting to EUR 57.7 billion.

Nonfinancial corporations' use of external financing declined slightly in 2019. Slower investment growth reduced the financing needs of corporations. According to preliminary financial accounts data, external financing was 1.8% below the value for 2018 (which in turn had fallen by more than one-quarter against the year before), amounting to EUR 18.4 billion. Equity financing, which had been slightly negative in 2018, remained low in 2019, providing only 10% of external financing, about one-quarter of which were listed stocks.

The bulk of external financing came in the form of debt, which, however, was EUR 3.1 billion or 16% lower in 2019 compared with 2018. Debt financing was mainly long-term (with maturities over one year), while short-term funding decreased. Almost all net debt flows came from



¹ Gross operating surplus and mixed income (self-employed and other nonincorporated businesses income).

domestic sources, with the financial sector and other nonfinancial corporations accounting for roughly one-half each. Within debt financing from other nonfinancial corporations, trade credit continued to play a prominent role. Yet, trade credit, which typically moves in tandem with overall economic activity, fell by more than one-third against 2018 (including cross-border flows). In contrast, loans from other enterprises, which largely reflect transactions within corporate groups, increased slightly. Net debt flows from the domestic financial sector were attributable to monetary financial institutions (MFIs).

Loans by Austrian MFIs contributed almost half of nonfinancial corporations' external financing in 2019. After abating somewhat toward the end of 2019 and in the first two months of 2020, lending by Austrian banks to domestic nonfinancial corporations gained impetus due to crisis-related short-term funding needs. In March 2020, its annual growth rate (adjusted for securitization as well as for reclassifications, valuation changes and exchange rate effects) reached 6.4% in nominal terms against 5.4% in the month before (see left-hand panel of chart 2.2). Still, this was noticeably below the 7.2% recorded one year earlier as well as below the loan growth rates recorded in the run-up to the financial crisis.²

Before the crisis struck, loan growth had been driven mostly by long-term loans. On the one hand, long-term loans are most relevant for business fixed capital investment. On the other hand, this at least in part reflects the industry structure of the portfolio of loans to nonfinancial corporations. Real estate-related industries (construction and real estate activities) remained the main driver of MFI lending to the corporate sector, accounting for 60% of total loan expansion in 2019 (adjusted for reclassifications and valuation changes but not for exchange rate effects). Loans to these industries – in particular to real estate activities, which account for 75% of outstanding loans – are predominantly long-term. In contrast, in industries such as manufacturing and trade, where loan growth had been much lower or even negative, less than half of the outstanding loan volume is long-term. In March 2020, however, the largest part of loan growth was attributable to short-term lending, reflecting current funding requirements.

Corporate loan demand surged in the first quarter of 2020. According to the Austrian results of the euro area bank lending survey (BLS), loan demand was particularly high for short-term loans, reflecting emergency financing needs for inventories and working capital due to the COVID-19 crisis, as well as for debt refinancing, restructuring and renegotiation. For the second quarter of 2020, banks expected net demand for loans to increase further. At the same time, Austrian banks said that they had tightened their credit standards only slightly in the first quarter of 2020, which might also be the result of the policy measures taken by the Eurosystem immediately after the outbreak of the COVID-19 crisis and the higher resilience of the Austrian banking sector. The share of rejected applications for loans to enterprises remained stable in the first quarter of 2020, after having increased in the three previous years.

Before the onset of the crisis, nonfinancial corporations continued to have substantial liquidity at their disposal. Credit lines granted by banks

² At the cutoff date, financial accounts data were available up to the fourth quarter of 2019. More recent developments of financing flows are discussed based on data from the MFI balance sheet statistics.

continued to increase up to the first quarter of 2020, rising by 5.9% year on year in March 2020. As firms utilized only a part, undrawn credit lines available to enterprises increased in the second half of 2019 and the first quarter of this year, rising by 5.0% year on year in March 2020. Moreover, firms' transferable deposits continued to rise (by 6.5% in March 2020). In real terms, transferable deposits were twice as high as before the onset of the financial crisis in 2008. These liquidity buffers provided corporates with some resilience against temporary funding stress even if they may have been insufficient in many cases. Responding to firms' immediate liquidity needs, the government stepped in with loan guarantee schemes to support Austrian small and medium-sized enterprises.

Credit conditions were tightened following the outbreak of the COVID-19 crisis. Bank lending rates remained low until February 2020. In March 2020, however, interest rates on new loans to nonfinancial corporations rose on average by almost $\frac{1}{4}$ percentage point against the month before, probably reflecting higher risk premiums. In the BLS, banks replied that interest margins widened in the first quarter of 2020, both on average loans to nonfinancial corporations and – to a larger extent – on riskier loans to firms. Other terms and conditions, such as collateral requirements and loan covenants, were left unchanged overall, according to the survey.

The debt sustainability of Austrian nonfinancial corporations deteriorated slightly in 2019. In the course of the year, the debt-to-income ratio of the corporate sector increased by 6 percentage points to 396% (see left-hand panel of chart 2.3), as the growth of financial debt (measured in terms of total loans raised and bonds issued), despite being rather low at 1.8%, surpassed the expansion rate of gross operating surplus. Compared to 2008, i.e. the time before the onset of the financial crisis, the debt-to-income ratio of nonfinancial corporations was about 50 percentage points higher, pointing to comparatively weaker medium-term corporate debt sustainability.

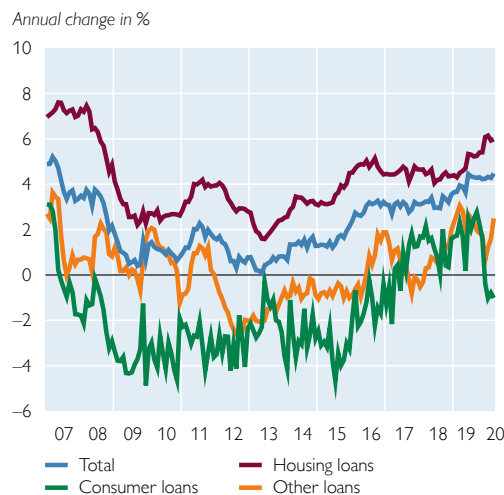
Chart 2.2

MFI loans to Austrian nonfinancial corporations and households (2007–2020)

Loans to nonfinancial corporations



Loans to households



Source: OeNB.

The debt servicing capacity of the corporate sector was supported by the low interest rate environment. The interest burden of nonfinancial corporations remained at historically low levels in 2019. The ratio of interest payments for (domestic) bank loans to gross operating surplus remained unchanged in 2019, at less than 3%, compared to more than 9% in 2008 (see middle panel of chart 2.3). While declining interest rates reduced the interest service burden on both outstanding variable rate loans and new debt, the buoyant increase of loan volumes as well as the shift toward long-term loans – which still have slightly higher interest rates than short-term loans – caused interest expenses to rise. The share of variable rate loans in new euro-denominated loans, which had declined in the years before, rebounded, climbing by 3.7 percentage points to 84.7% in the final quarter of 2019.

The number of insolvencies declined by 9% in the first quarter of 2020. However, according to the creditor protection agency KSV 1870, this reduction was mainly due to the last two weeks in March, which brought about a 50% drop in insolvencies resulting from the temporary suspension of the obligation for corporations to file for bankruptcy in the event of overindebtedness. Looking ahead, insolvencies are expected to rise significantly, in the majority of cases caused by liquidity problems, but overindebtedness will also be a factor as the ability to refinance critically depends on a company's equity position.

Household loans in Austria continued to grow

Households' financial investments rose by 12% to EUR 15.6 billion in 2019. The increase in financial investments was mainly attributable to net investments in capital market instruments, which increased from EUR 0.4 billion in 2018 to EUR 2.5 billion in 2019. Households continued to transfer funds to mutual funds and also invested in listed stocks, while direct holdings of debt securities were reduced. For all three asset categories, households experienced (unrealized) valuation gains of EUR 10.5 billion in 2019, equivalent to 9.7% of the amount outstanding at the end of the year before. However, the sharp correction of financial asset prices in the wake of the COVID-19 crisis brought about a heavy erosion of valuations from March 2020 onward. Yet, capital market investments in general and stocks in particular are very much concentrated in the portfolios of households with higher income, as the results of the Household Finance and Consumption Survey (HFCS) for Austria show.

In the low nominal interest rate environment, households continued to prefer liquid assets. Households put about EUR 13.7 billion – equivalent to almost 90% of total financial investments – into overnight deposits with domestic banks. Net investments in (both life and non-life) insurance remained negative in 2019, while net investments in pension entitlements (including both claims on pension funds and direct pension benefits granted by private employers) as well as investments in severance funds remained broadly stable.

Bank lending to households maintained its momentum up to the first quarter of 2020. In March 2020, bank loans to households (adjusted for reclassifications, valuation changes and exchange rate effects) rose by 4.3% year on year in nominal terms (see right-hand panel of chart 2.2). Reflecting the decrease in consumption of durables in 2019, consumer loans were down 1.0% year on year. Other loans, which include loans to sole proprietors and unincorporated

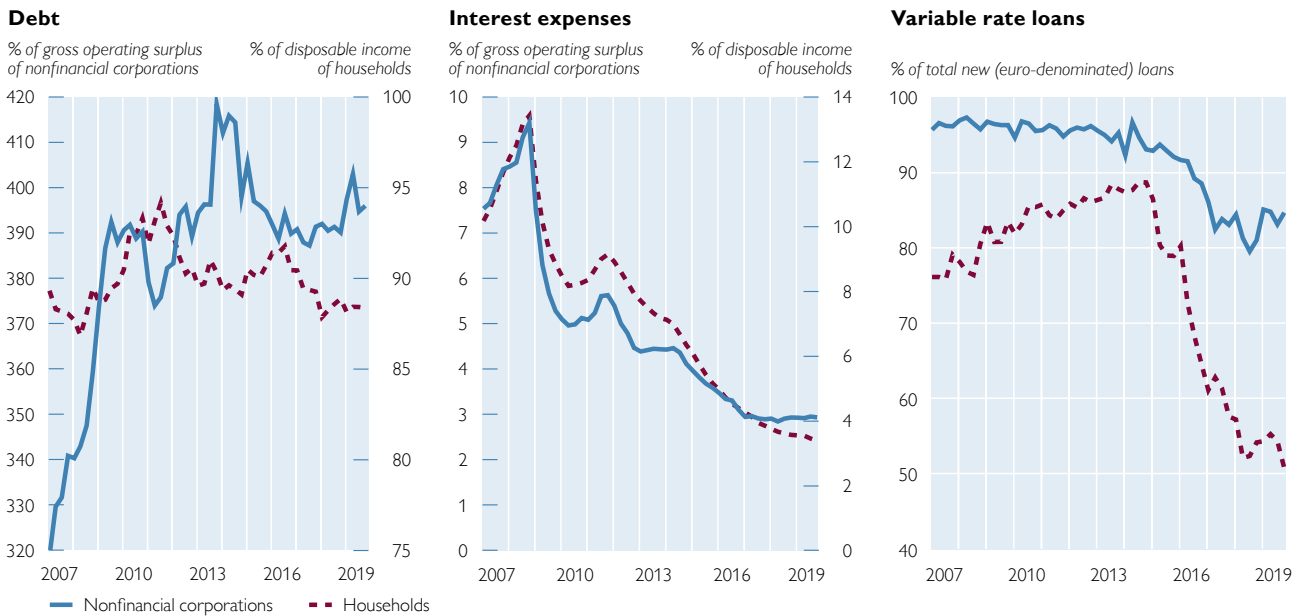
enterprises, rose by 1.5%. The main contribution to loan growth came from housing loans, not only because the latter are the most important loan category for households – accounting for more than two-thirds of the total outstanding volume – but also because they registered the highest growth rate of all loan purpose types, reaching 6.0% year on year in March 2020. The vivid expansion of housing loans in 2019 reflected, among other things, the growth in the number and the volume of real estate market transactions. The transaction volume increased by 7.8% to EUR 34.4 billion in 2019, according to data compiled by REMAX. According to the BLS, Austrian banks reported an even stronger increase in household demand for housing loans in the first quarter of 2020 than in 2019. At the same time, banks left their credit standards for housing loans unchanged.

The conditions for housing loans remained favorable. Interest rates for new housing loans from banks fell further in 2019 and in the first two months of 2020 but increased by 4 basis points in March 2020. As to interest margins, banks replied in the BLS that margins on average housing loans were stable in the first quarter of 2020, after having been lowered continuously in the past three years, whereas margins on riskier loans were tightened somewhat.

Aggregate credit risk indicators of the household sector remained broadly stable in 2019. Total gross liabilities of the household sector grew by 3.3% in nominal terms in 2019, somewhat more slowly than net disposable income, resulting in a slight decrease of the debt-to-income ratio to 88.4%, which was slightly higher than in 2008 and about 6 percentage points lower than at the height of the global financial crisis (see left-hand panel of chart 2.3). While households entered the COVID-19 crisis with some resilience regarding their incomes thanks to solid wage growth up to the onset of the crisis, the ensuing shock has severely affected incomes and triggered a stark increase in unemployment, strongly impairing household resilience.

Low interest rates have reduced debt servicing costs. Households' interest expenses on outstanding bank loans equaled 1.5% of aggregate disposable income in the fourth quarter of 2019, more than 2 percentage points less than in 2008. A further mitigating – albeit only short-term – effect should come from the loan repayment moratorium that borrowers can request for payments until mid-2020 if their ability to repay has been adversely affected by the COVID-19 crisis. Although the share of loans with an initial rate fixation period of up to one year declined further, more than half of all new loans (50.7%) extended to households in the fourth quarter of 2019 were variable rate loans. However, regardless of this recent decline, the share of variable rate loans is still quite high compared to the euro area average. Also, FX loans (which are mostly variable rate loans) decreased further in 2019 – to 8% of all outstanding loans (and about 10% for housing loans) – but remain risky.

Risk indicators for Austrian nonfinancial corporations and households



Residential property prices in Austria continued to rise up to the outbreak of the crisis. In the first quarter of 2020, prices were 3.4% higher than one year earlier. The OeNB fundamentals indicator for residential property prices reached 12.3% in the fourth quarter of 2019, implying that the overvaluation observed in recent years abated slightly in 2019.