Corporate and household sectors in Austria: financing conditions remain favorable[1]

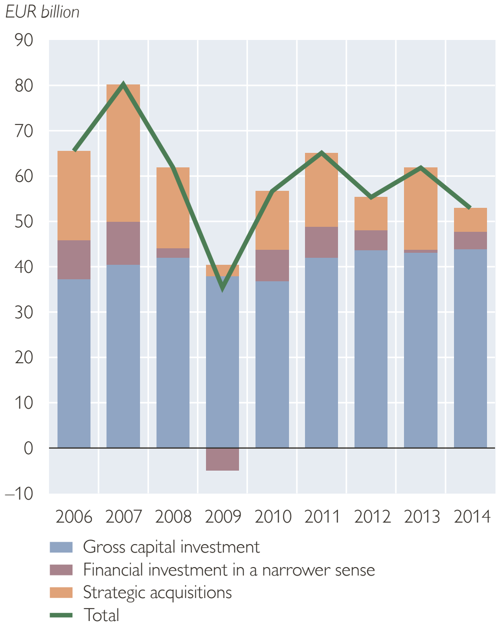
Nonfinancial corporations' financial position supported by low interest rates

Austrian economic growth remains weak

In 2014, the Austrian economy expanded by 0.4% in real terms (in seasonally and working day-adjusted terms), thus growing by less than 1% for the third consecutive year. In the first quarter of 2015, growth remained weak. Although the euro area has emerged from recession, the still weak economic growth has failed to kick-start the Austrian economy. Gross fixed capital formation contracted over the course of 2014 as well as in early 2015 as uncertainties regarding future sales prospects increased. The subdued development of real disposable household income in Austria dampened domestic sales expectations, whereas exports, driven by increasing foreign demand and the weak euro exchange rate, gained momentum in 2014 and early 2015.

Chart 6

Use of funds by nonfinancial corporations



Source: OeNB, Statistics Austria.

Corporate propensity to invest remains muted

Financial investment reduced in 2014

In 2014, the total use of funds (i.e. the sum of gross capital formation and financial investments) of nonfinancial corporations was down 13.1% year on year (see chart 6). Financial investments of the corporate sector more than halved in 2014. In particular, strategic investments were reduced.[2] Financial investments in a narrower sense, which include all other items on the asset side according to financial accounts data, were considerably higher than in 2013, when they had been markedly reduced, but stayed below the 2012 level.

No substitution of capital formation by financial investment

Strong reliance on internal financing

Reflecting the subdued economic environment, the gross operating surplus of nonfinancial corporations fell slightly below the previous year's reading in 2014 (–0.2% in real terms), thus declining for the third year in a row, and was 10% below the pre-crisis level of 2007. This echoed the very modest increase of gross value added, which rose by 0.7% in real terms, while com-

[1] *All national and financial accounts data in this section are based on ESA 2010 and are therefore not comparable to the corresponding data in previous issues of the OeNB's Financial Stability Report.*

[2] *Strategic investments here include those items that (to a large extent) represent direct investments in other enterprises, namely shares (both listed and unlisted) and other equity held, as well as loans extended by nonfinancial corporations. However, portfolio investment in listed shares cannot be separated.*

pensation of employees rose considerably (1.4% per annum in real terms). Consequently, the downward trend in gross operating surplus, expressed as a percentage of gross value added in the corporate sector, that had been observed since 2012 persisted. By the end of 2014, the gross profit ratio had fallen to 41.2%.

Financing via quoted stocks gains momentum but is concentrated among a few enterprises

Equity accounts for more than half of external financing in 2014

Nonfinancial corporations' recourse to external financing in 2014 was down by one-quarter against the year before, amounting to EUR 9.0 billion. More than half of this amount was again accounted for by equity in 2014 (issuance of both quoted and unquoted shares), although at EUR 4.2 billion, equity financing was 27% lower than in the preceding year. The main part was generated through listed stocks, which had long been affected by the crisis, but began to show some signs of expansion in the course of the year. Net issuance of capital on the stock exchange – i. e. the sum of new listings, capital increases and delistings – amounted to EUR 3.4 billion in 2014. However, as the bulk of this overall issuance volume was attributable to three new listings and two capital increases on the Vienna stock exchange, this form of funding was available only to a small number of larger companies. In the first three months of 2015, no issuance was recorded according to securities issues statistics.[3] Unquoted shares and other equity instruments (mainly sales to foreign strategic investors), which had accounted for the lion's share of equity financing in the three years before, only contributed 18% to equity financing in 2014.

Debt financing muted

Less than half of the external financing raised in 2014 was accounted for by debt instruments. The primary source of debt financing for Austrian nonfinancial corporations was bank loans, especially those extended by domestic banks, which made up almost half of debt financing in 2014, while borrowings from foreign banks were reduced by EUR 1.1 billion.

Growth of bank loans remains weak

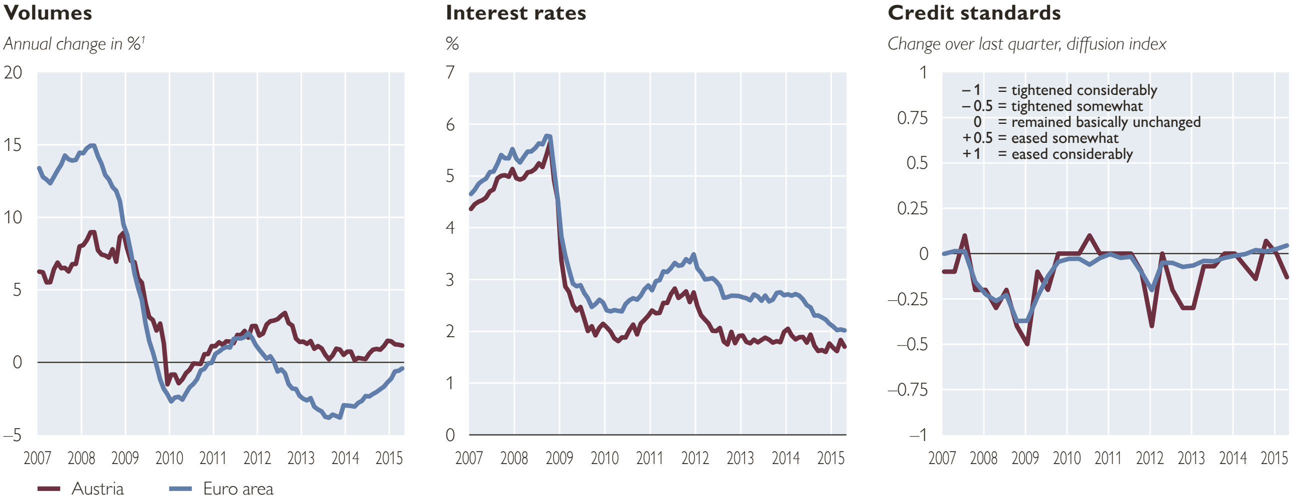
The growth of lending by Austrian banks to domestic nonfinancial corporations remained weak. For April 2015, MFI balance sheet statistics put the annual growth rate (adjusted for reclassifications, valuation changes and exchange rate effects) at 1.2% in nominal terms (see chart 7), implying that the growth of bank loans remained virtually flat in real terms. (Nominal) loan growth mainly came from medium-term maturities (over one year and up to five years), while loans with longer maturities – which had accounted for most of the loan growth in past years – grew only modestly.

Loan dynamics continued to be affected by both supply- and demand-side factors: On the one hand, banks remained cautious in their lending policies. According to the euro area bank lending survey (BLS), Austrian banks have slightly tightened their credit standards for loans to enterprises in 16 out of 29 quarters since 2008 and have eased them only twice. Even though in most instances the extent of tightening was relatively small, over the years it may have accumulated. Large firms were affected more strongly than small

[3] *At the cutoff date, financial accounts data were available up to the fourth quarter of 2014. More recent developments of financing flows are discussed on the basis of data from MFI balance sheet statistics and securities issues statistics.*

Chart 7

MFI loans to nonfinancial corporations



Source: OeNB, ECB.

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

and medium-sized enterprises (SMEs). The tightening of lending policies has been driven both by banks' capital positions and by heightened risk concerns.

On the other hand, loan demand by enterprises remained low in the currently weak cyclical environment. Although in the first quarter of 2015 banks surveyed in the BLS reported a slight increase in corporate loan demand for the first time since 2007, in 19 out of 29 quarters since the onset of the crisis the surveyed banks registered slight declines in corporate loan demand – which they attributed mainly to lower funding requirements for fixed investment. Thus, at least in the current environment of weak demand for loans, the somewhat more restrictive policies of Austrian banks probably did not constitute a binding constraint for the financing of Austrian enterprises.

The tighter credit standards, which indicate a more risk-adequate pricing of loans, were reflected in the terms and conditions of bank loans. Wider margins on loans partially dampened the effects of monetary policy easing on financing costs. Thus, the pass-through of the seven key interest rate cuts undertaken by the ECB between November 2011 and September 2014 (which totaled 145 basis points) was incomplete. Over the period from October 2011, the month before the first of the key interest rate cuts, and April 2015, corporate lending rates declined by 107 basis points. Although interest rates fell for all loan amounts and maturities, they decreased more markedly in the case of larger loan amounts (more than EUR 1 million). The spread between interest rates on larger loans and those on loans of lesser amounts, which – given the lack of other data – is commonly used as an indicator of the relative cost of financing for SMEs, averaged 42 basis points in the first four months of 2015, one of the lowest levels recorded in any euro area country.

Favorable interest rates for bank loans

Market-based debt, which had been a major source of external finance for the corporate sector in the previous years, was reduced by 1% in 2014 (measured against the outstanding volume of end-2013), according to financial accounts data. Data from securities issues statistics indicate net issuance recovered somewhat in the first months of 2015. In March 2015, corporate bond issuance was up 2.5% year on year. However, this form of funding is available only to a limited number of mainly larger companies. Moreover, it has to be taken into account that a considerable part of the enterprises that issue bonds have been reclassified to the government sector in the course of the implementation of ESA 2010.

Low interest rates strengthen debt-servicing capacity of the corporate sector

As a result of both the slowdown in external financing as well as the ongoing recourse to equity financing, corporate debt (viewed in terms of total loans raised and bonds issued) rose quite modestly in 2014 (by 2.2%). As the expansion rate of the gross operating surplus was low as well, the debt-to-income ratio of the corporate sector remained virtually stable in 2014 at 419% (see chart 8). However, it still remained considerably above pre-crisis levels, implying that the increase in the corporate sector's vulnerability that occurred in the period from 2007 to 2009 has not yet been reversed.

Falling number of insolvencies

High share of variable rate loans

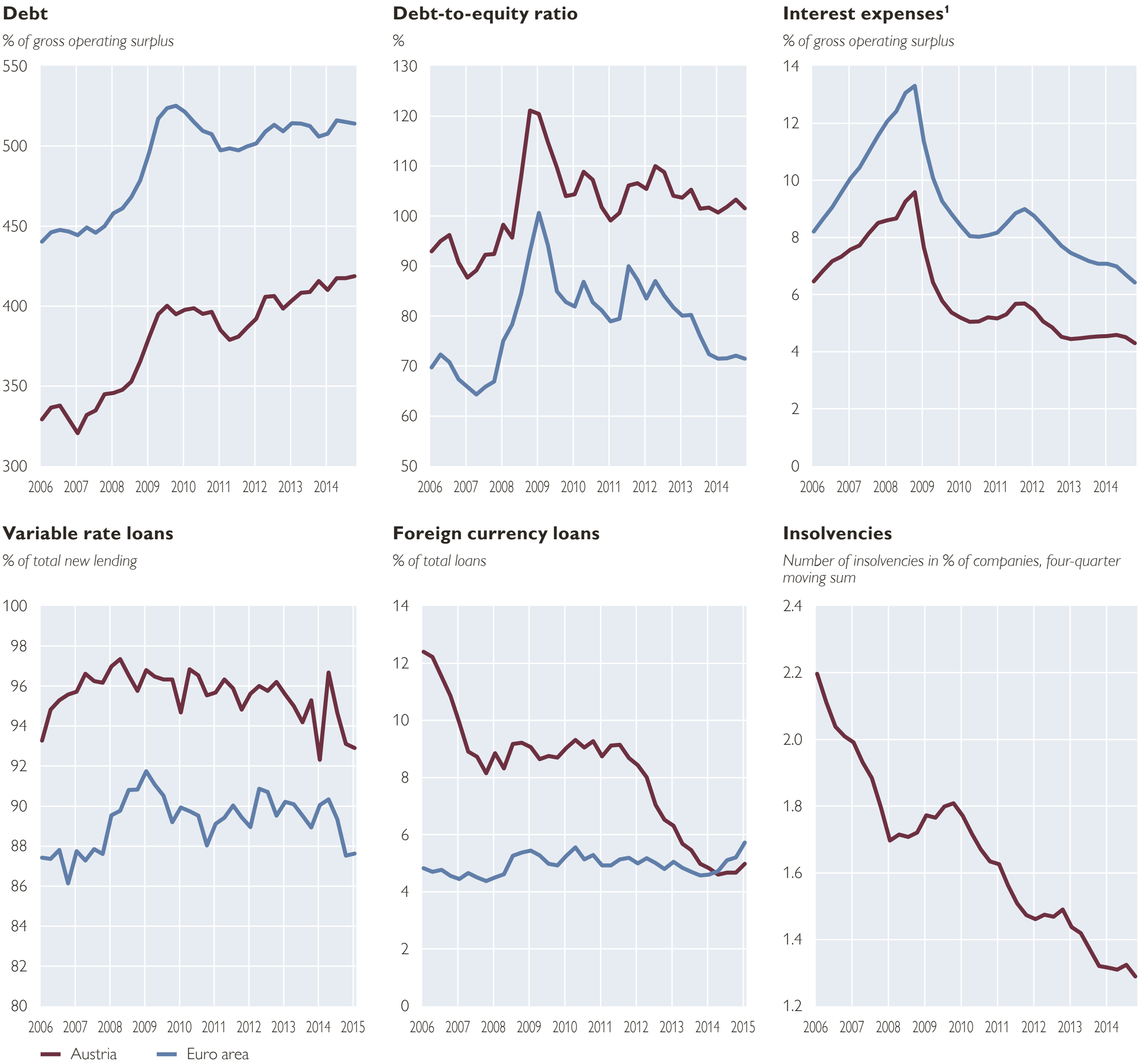
The low-interest environment continued to support firms' ability to service their debt. In 2014, the proportion of gross operating surplus that was spent on interest payments for bank loans declined slightly further, benefiting from the very high share of variable rate loans. While Austrian companies therefore currently face lower interest expenses than their euro area peers, their exposure to interest rate risk is considerably higher. A rebound of interest rates could thus become a significant burden, especially for highly indebted companies, even if rising debt servicing costs may eventually be partially offset by the positive impact an economic recovery would have on firms' earnings.

The corporate sector's exposure to foreign exchange risk, which has never been as high as that of the household sector, remained low in 2014 and the first quarter of 2015, amounting to 5.0% at the latest reading. Since the second quarter of 2014, the share of foreign currency loans has been below the figure for the euro area as a whole.

The insolvency ratio (number of corporate insolvencies in relation to the number of existing companies) continued to decline until the fourth quarter of 2014 (based on a moving four-quarter sum to account for seasonality). This development may be attributed to the moderate increase of debt financing and the low interest rate level (which makes debt servicing easier even for highly indebted companies) but also to the fact that insolvencies usually lag cyclical movements.

Chart 8

Risk indicators for nonfinancial corporations



Source: OeNB, ECB, Eurostat, Kreditschutzverband von 1870.

[1] *Euro area: euro loans only.*

Foreign currency risks remain a concern for the household sector

Development of households' real income recovered in the second half

Despite weak economic growth, the employment trend was remarkably robust in 2014 and the first months of 2015. The number of employed persons and working hours still showed positive rates of change. At the same time, unemployment continued to climb in view of rising labor participation rates. Households' real disposable income increased in the second half of 2014 after it had shrunk in the first half. The saving rate of the household sector remained clearly below the long-term average of 10% (1999–2013). Low sav-

Saving rate remains low

ing rates are typical of periods with low income growth, when households save less in order to smooth their consumption levels. Furthermore, the low-interest environment may also have reduced the attractiveness of saving.

Financial investment by households still below pre-crisis levels

As a result of the low saving rate, financial investments by households remained subdued in 2014. Although at EUR 9.7 billion they surpassed the previous year's level by almost one- quarter in nominal terms, they were still more than 10% below the 2012 value and less than half of the pre-crisis level (see chart 9). Hence, the increase in 2014 most likely does not point to a turnaround in households' financial investments.

Strong liquidity preference

The structure of households' financial investments showed the same pattern in 2014 as it had done in the years since the onset of the crisis. As households still displayed a strong preference for liquidity, given the low opportunity costs resulting from the low-interest environment, more than 40% of households' financial investment flowed into cash holdings and deposits with banks. For the third year in a row, bank deposits with agreed maturity declined, while overnight deposits saw further significant inflows.

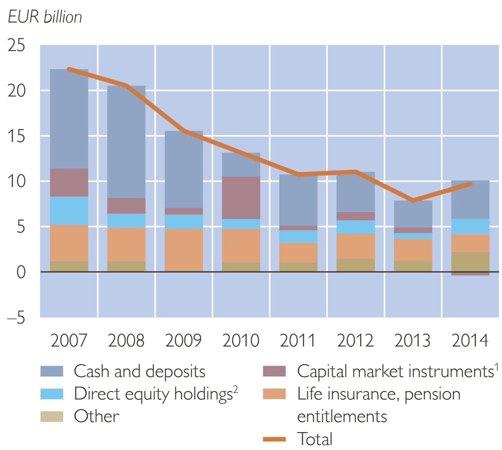
Households' net financial investment in capital market instruments, which had already been muted in the years before, became negative in 2014 (EUR –0.4 billion). In particular, households shunned investments with longer interest rate fixation periods and reduced their direct holdings of long-term debt securities (especially bonds issued by domestic banks). Conversely, households invested EUR 3.3 billion in mutual funds and another EUR 0.6 billion in direct holdings of quoted stocks, in an ongoing search for yield in a low-interest environment.

Investment in life insurance and pension entitlements (the latter including both claims on pension funds and direct pension benefits granted by private employers) continued to slow down in 2014 and at EUR 2.0 billion registered the lowest value since the time series began in the mid-1990s. This decrease was driven mainly by life insurance policies, where net investments fell by 60% against the previous year, again reflecting the strong preference for liquidity. A large proportion of the inflows into these instruments were not an outcome of current investment decisions, but rather – given the long maturities and commitment periods involved – reflected past decisions. A key factor in this context is demand for funded pension instruments; moreover, life insurance policies often serve as repayment vehicles for foreign currency bullet loans (even if these are converted into euro loans).

As a result of rising share and bond prices, the Austrian household sector, on aggregate, again recorded consider-

Chart 9

Households' financial investment



Source: OeNB.

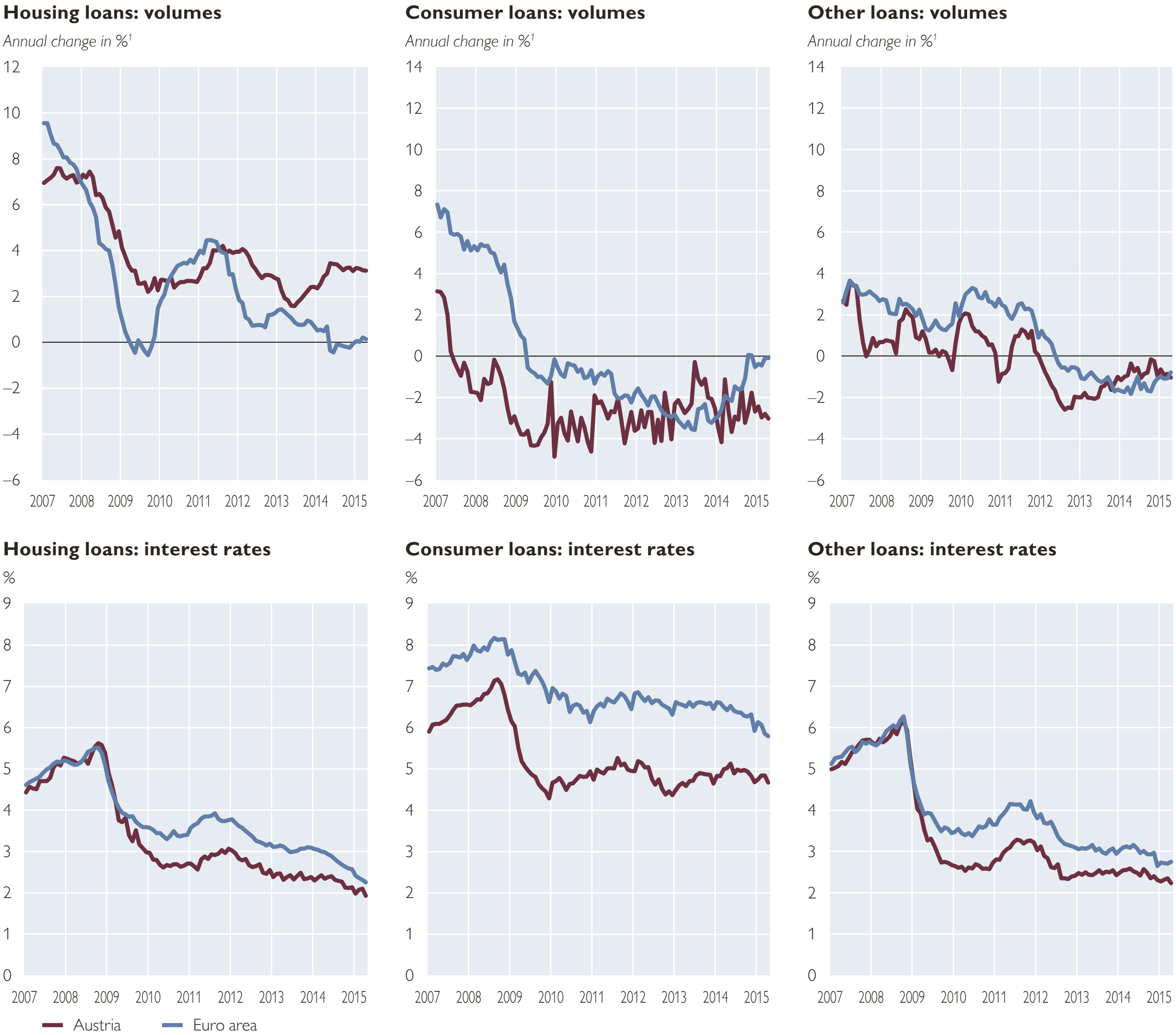
1 Debt securities, mutual fund shares and listed shares.
2 Unlisted shares and other equity.

able (unrealized) valuation gains on its securities portfolios in 2014,[4] totaling EUR 1.9 billion, which was equivalent to 1.8% of households' securities holdings at the end of 2013. Valuation gains were registered for long-term debt securities and mutual fund shares, whereas quoted stocks issued by domestic enterprises registered valuation losses in 2014. While these unrealized valuation gains contributed to a notional increase in the financial wealth of households in the first half of 2014, valuation developments are very vola-

Considerable (unrealized) valuation gains

Chart 10

MFI loans to households: volumes and conditions



Source: OeNB, ECB.

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

[4] *However, it should be taken into account that according to data from the Household Finance and Consumption Survey (HFCS), only about 15% of the Austrian households own securities.*

tile and can shift in the opposite direction as well (as they have done in the past).

Growth of household loans remains muted

Housing loan expansion on a stable path

Little change in household indebtedness

The expansion of bank lending to households remained subdued until the first quarter of 2015. In April 2015, bank loans to households (adjusted for reclassifications, valuation changes and exchange rate effects) increased by 1.3% in nominal terms. A breakdown by currency shows that euro-denominated loans continued to grow briskly (by 5.6%), while foreign currency loans continued to contract at double-digit rates – in April 2015, they had fallen by 15.2% year on year. Broken down by loan purpose (see chart 10), consumer loans and other loans shrank by 3.0% and 1.0% year on year, respectively, while housing loans grew by 3.1% year on year. The favorable financing conditions probably supported the dynamics of lending for house purchases, with housing market indicators also pointing to an increase in demand. The still rising house prices (see below) may have boosted the funding needs for real estate investment. The transaction volume on the residential property market in Austria increased by 21.6% in nominal terms, according to data published by RE/MAX and compiled from the land register by IMMOunited, also implying an increase in financing needs. At the same time, there are no indications that banks have relaxed their credit standards for housing loans. According to the Austrian BLS results, standards have been eased slightly only twice since the beginning of 2013, after having shown very little movement in the years before.

Lending terms and conditions remained favorable. Interest rates on short-term loans (for interest rate fixation periods of up to one year) stood at 2.31% in April 2015, 0.51 percentage points down year on year. A look at data on lending rates across the entire maturity spectrum reveals that interest rates on new housing loans stood at 1.93% in April 2015, 0.41 percentage points lower than twelve months before. Over the same period, interest rates on consumer credit dropped by 0.35 percentage points to 4.67%.

Households' currency and interest rate risks

By the end of 2014, the household sector's total liabilities amounted to EUR 166.4 billion, according to financial accounts data, a mere 0.7% up in nominal terms on last year's figure, reflecting low loan growth. Expressed as a percentage of net disposable income, household debt decreased by 1.3 percentage points to 87.7% in 2014 (the third consecutive annual decrease; see chart 11). The debt ratio of households in Austria thus remained lower than in the euro area as a whole. Moreover, it should be taken into account that according to data from the Household Finance and Consumption Survey (HFCS), only 36% of Austrian households have taken out a loan.

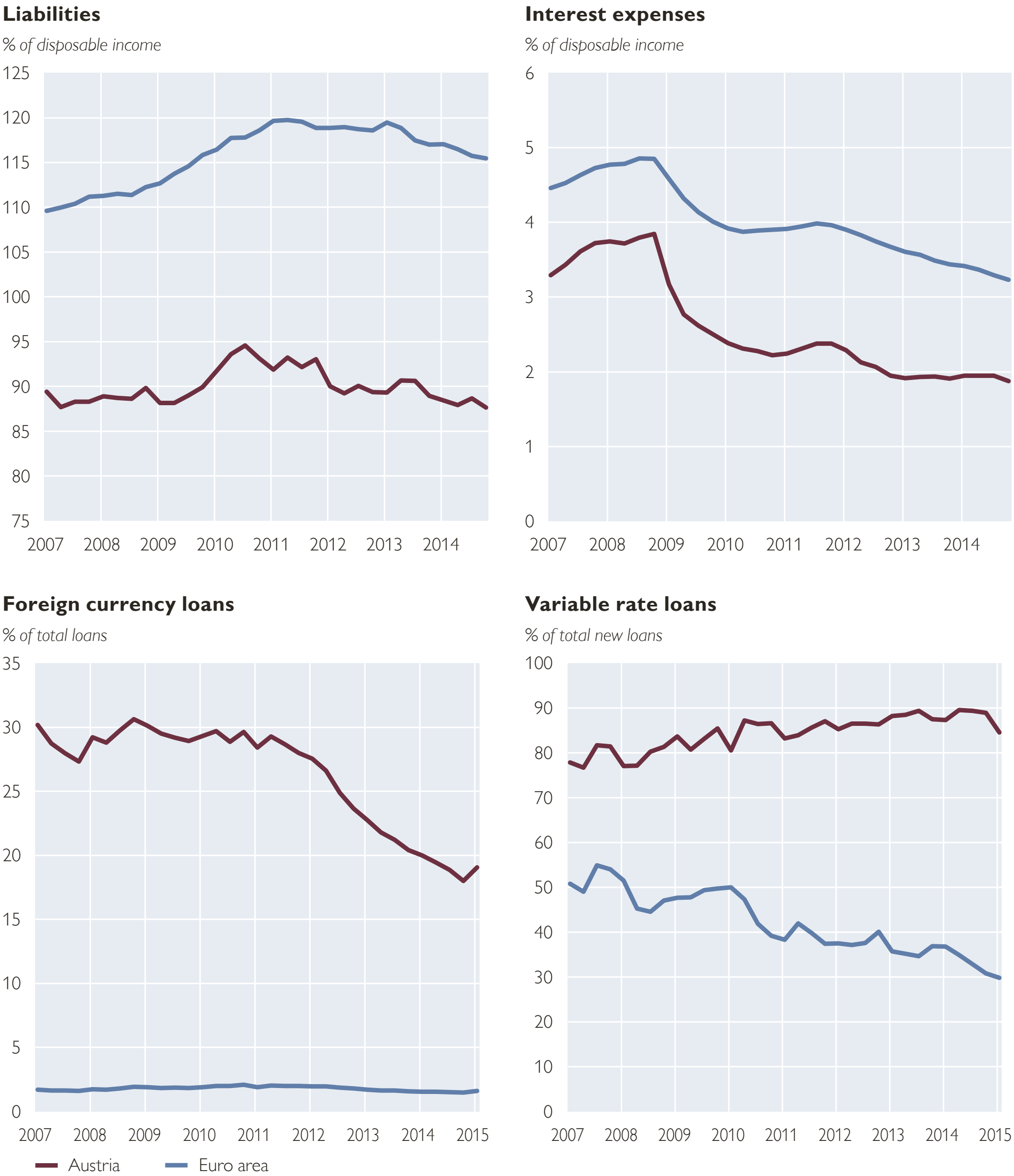
Given modest debt growth and low interest rates, households' interest expenses remained low. In the fourth quarter of 2014, they equaled 1.9% of their aggregate disposable income, almost 2 percentage points less than in 2008, the year before interest rates had begun to fall. One of the factors behind the acceleration of the decline was the high share of variable rate loans: In the first quarter of 2015, loans with an initial rate fixation period of up to one year accounted for almost 85% of new lending (in euro) to households, a very high proportion by international standards. On the one hand, the pass-through of the ECB's lower key interest rates to lending rates was therefore faster in Austria than in the euro area as a whole. Loan quality may have also played a role, given Austrian households' comparatively low level of indebtedness. On the other hand, this high share of variable rate loans in total lending implies considerable interest rate risks in the balance sheet of the household sector.

Considerable foreign currency risks

The still very high share of foreign currency loans in total lending remains a major risk factor for the financial position of Austrian households, despite a noticeable decrease in the past years. This risk was highlighted in January 2015 when, as a result of the strong

Chart 11

Indicators of household indebtedness



Source: OeNB, Statistics Austria, ECB, Eurostat.

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

appreciation of the Swiss franc following the decision of the Swiss National Bank to discontinue the minimum exchange rate of CHF 1.20 per euro, the foreign currency share rose from 18.0% to 19.5% within one month. However, during the following months, the share of foreign currency housing loans continued to edge down, reaching 18.9% in April 2015. Almost all outstanding foreign currency-denominated housing loans are denominated in Swiss franc (close to 97%).

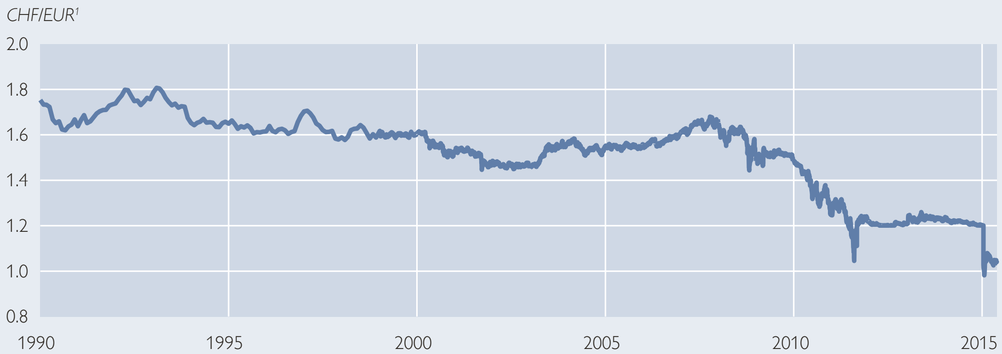
Box 1

Microsimulation: how exchange rate shocks would affect FX borrowers in Austria[1]

Over the last years, the allocation of new foreign currency (FX) loans to the household sector has been reduced considerably, to about 1% at end-2014. However, the stock of FX loans granted to the household sector remains relatively large; it amounted to about 20% of total household debt at end-2014. Valuation effects play an important role in explaining why the stock of FX loans is still as large as it is. In particular, as more than 95% of all FX loans held by Austrian households are denominated in Swiss francs, the appreciation of this currency against the euro during the last years and months (see chart 1) has directly increased the outstanding amount of these loans.

Chart 1

Exchange rate development of the Swiss franc



Source: OeNB.

[1] Up to end-1998: ATS.

We can get a closer look at how these exchange rate developments are affecting FX borrowers by combining exchange rate time series macrodata with household-level microdata from the Austrian Household Finance and Consumption Survey (HFCS) 2010. By matching the average exchange rate in each year with the year in which a household's highest FX loan was taken out, one obtains the initial exchange rate for each household's FX loan[2] in the HFCS. This makes it possible to look at the distribution of initial exchange rates across FX borrowers and to simulate the effect of different exchange rate shocks on FX borrowers.

Chart 2 shows how the initial CHF/EUR exchange rate at the time a household's FX loan was taken out is distributed across all Austrian households with FX loans. 90% of FX borrowers took out their FX loans at an exchange rate level of 1.47 or higher, 50% at an exchange rate level of 1.55 or higher, and 10% at an initial exchange rate of 1.64 or higher. If these

[1] *This box is based on: Albacete, N. and P. Lindner. 2015. Foreign currency borrowers in Austria – evidence from the Household Finance and Consumption Survey. In: OeNB. Financial Stability Report 29.*

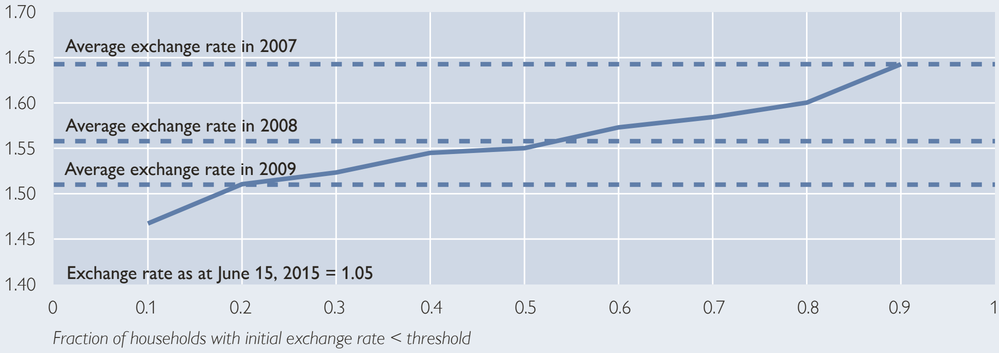
[2] *In the following, any references to a household's FX loan shall be meant to be understood as the household's highest FX loan if a household has several FX loans.*

exchange rate levels are compared with the current exchange rate, it is obvious that households are currently experiencing large (unrealized) losses due to the appreciation of the Swiss franc. At the current CHF/EUR exchange rate level of 1.05 (as at June 15, 2015), the median FX borrower is suffering (unrealized) losses of 47% of the initial outstanding amount of his or her FX loan. This comparison also suggests that currently no FX borrower is enjoying (unrealized) profits in terms of a favorable exchange rate development.

Chart 2

Distribution of FX loan holders' initial CHF/EUR exchange rate

CHF/EUR exchange rate at the time the household's highest FX loan was taken out



Source: HFCS 2010, OeNB.

Chart 3 shows the results of simulating the effects of a return to exchange rate levels as those experienced between 1990 and 2015 on each FX borrower in the HFCS. Households which took out their FX loans at a time when the exchange rate was lower than the simulated one are defined as "exchange rate losers" because they would be experiencing (unrealized) losses. The top left panel in chart 3 shows that if the Swiss franc became as weak as it was during the early 1990s or in 2007, the share of exchange rate losers would be very low – below 5% of FX borrowers. However, simulating exchange rates as those observed in 2002 or since 2010 produces shares of exchange rate losers of more than 95%.

The bottom left panel in chart 3 shows the debt share held by the exchange rate losers derived from the above simulation. It ranges from 1% of aggregated household debt, if exchange rates were as in the early 1990s or in 2007, to around 30% if exchange rates were as in 2002 or since 2010. Still, the risks to financial stability stemming from such scenarios seem to be rather low, as the unsecured[3] debt share held by the exchange rate losers in the simulation is below 4% in all scenarios. This suggests that most Austrian FX borrowers should have enough resources to repay their FX debt.

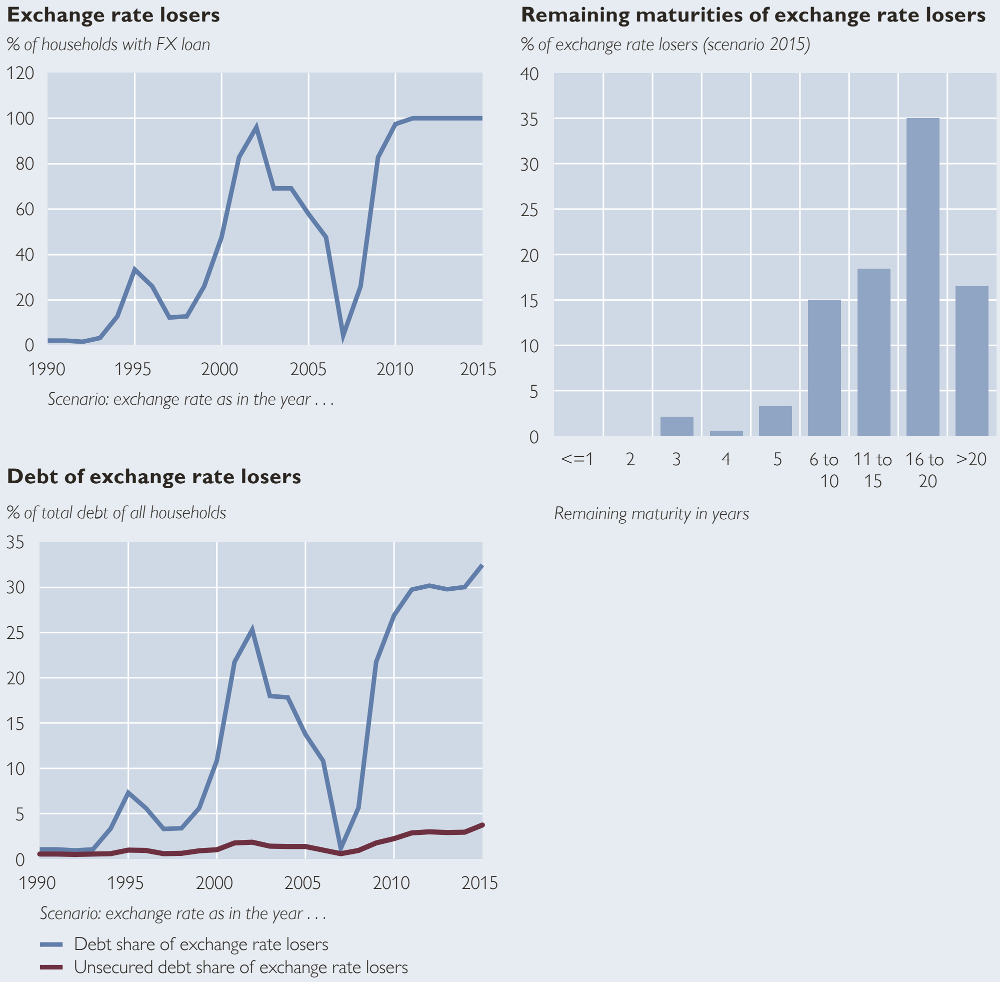
Finally, the right-hand panel in chart 3 shows that, according to HFCS 2010 data, the remaining maturities of FX borrowers' FX loans are relatively large for most households. For 18% of FX borrowers, residual maturity lies between 11 and 15 years, for 35% of FX borrowers it lies between 16 and 20 years, and for 17% of FX borrowers it lies above 20 years.[4] As most FX loans in Austria are bullet loans, this suggests that the above estimated (unrealized) losses will remain unrealized for some time, which can be used to find a solution to this problem.

[3] *A household's unsecured debt is defined as the household's debt that remains after deducing the household's total financial and real assets.*

[4] *These numbers refer to the survey year 2010. Today, the remaining maturities would be reduced by 5 years.*

Chart 3

Microsimulation of exchange rate scenarios



Source: HFCS 2010, OeNB.

Residential property price growth in Austria slowed down

Price dynamics differ across regions

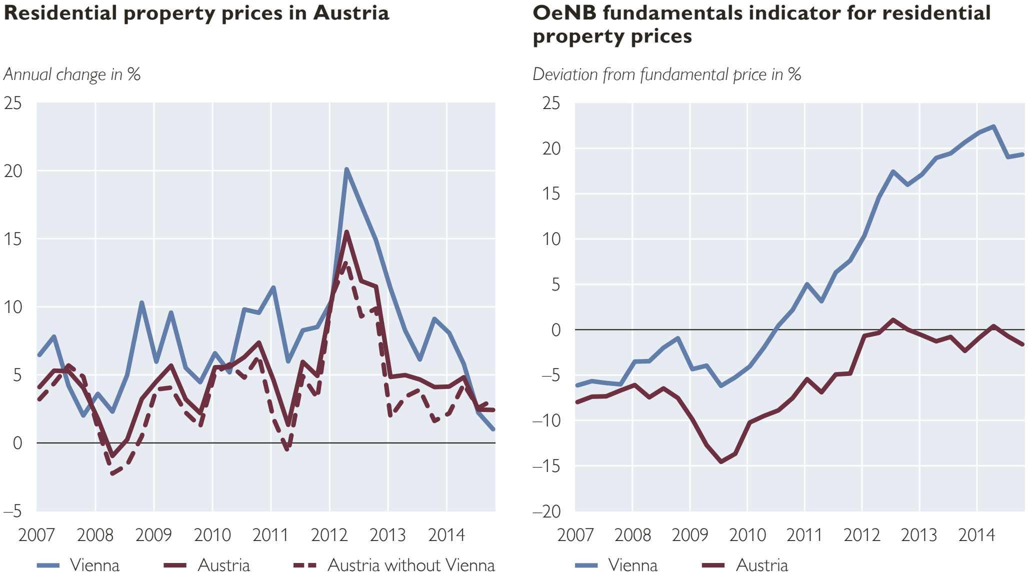
Over the past ten years, real estate prices in Austria rose at a clearly stronger pace than prices in the EU. In the course of 2014, however, price increases on the Austrian residential property market moderated considerably. In the fourth quarter of 2014, property price rises slowed to 2.4% year on year and even declined by 0.5% quarter on quarter. Price dynamics remained heterogeneous across regions. In Vienna, property price growth had continually subsided in the course of the year, coming to 1.0% year on year in the fourth quarter of 2014, whereas in Austria excluding Vienna price growth accelerated further, reaching 3.2% year on year. According to the OeNB fundamentals indicator for residential property prices, residential property prices in Vienna were overvalued by 19% in the fourth quarter of 2014. For Austria as a whole, the indicator suggested that prices were broadly in line with fundamentals (2% below fundamental values).

Demand for residential property in Austria has been driven by demographic change and by investors' choices. Since

2011, population growth in Austria has steadily picked up speed. In addition, the heightened propensity of investors to choose real estate over other assets for investment also seems to have played a role in strengthening demand. From an investor's perspective, the rising ratio of property prices to rents observed in Vienna – and also in the rest of Austria in 2014 – is an indication of contraction of the yields on real estate investments. On the supply side, housing investment advanced only slightly in 2014 in real terms (0.4%) after having contracted in the two previous years.

Chart 12

Austrian residential property market



Source: Wolfgang Feilmayr, Department of Spatial Planning, Vienna University of Technology; OeNB.