

Austria's Real Economy: Slight Increase in Corporate Debt

Corporate Loan Growth Picks Up Somewhat

Investment Activity Recovering

The Austrian economy expanded at a vigorous 3% in 2011 but lost much of its momentum in the second half of the year, as it was unable to decouple itself from the global economy. While export growth almost stagnated, strong domestic demand helped prevent a recession. In early 2012, the Austrian economy returned to a growth path. After having declined for two years in a row, fixed capital formation in 2011 reached the strongest annual growth rate in decades. This was attributable to demand for replacement investments and to above-average capacity utilization levels thanks to favorable economic conditions until mid-2011. As export growth declined and capacity utilization levels dropped, investment momentum slowed gradu-

ally but still outpaced the growth in other components of domestic demand. Construction investment, which had contracted for three consecutive years, also increased again somewhat in 2011.

Investment demand was supported by corporate profits, which continued to increase in 2011 (albeit at a declining rate in the course of the year). Corporate profit growth was driven by the robust economic activity observed up to the first half of 2011 and the associated rise in sales. At the same time, moderate wage increases helped contain corporate costs. In addition, the nonoperational component of corporate profitability was boosted by the relatively low interest rate level. While gross operating surplus has been above pre-crisis levels since the second quarter of 2011, the gross profit ratio (i.e. gross operating surplus in relation to gross value added of the

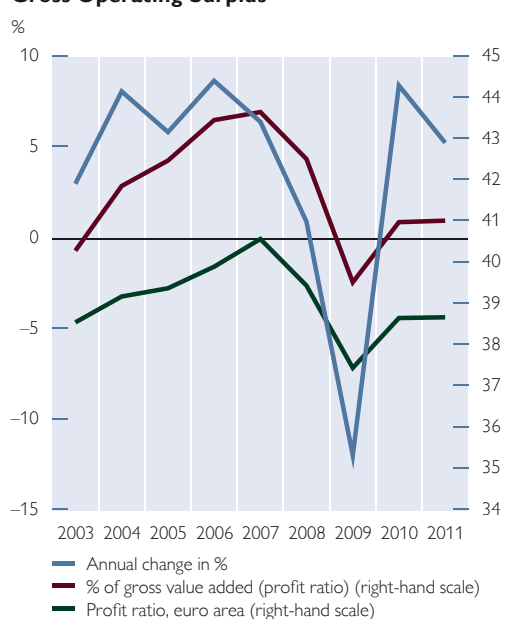
Economy stabilizes in early 2012

Profits continue to rise

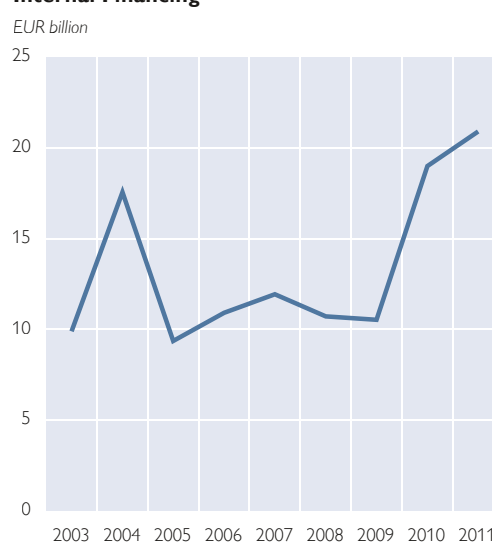
Chart 7

Profitability and Internal Financing of Nonfinancial Corporations

Gross Operating Surplus



Internal Financing¹



Source: Statistics Austria.

¹ Internal financing = gross savings – consumption of fixed capital + capital transfers.

corporate sector) has yet failed to reach its pre-crisis highs, remaining virtually unchanged at 41.0% in 2011, a level still markedly higher than the comparative level in the euro area.

External Financing Has Declined Further

The corporate sector's continued high profitability was reflected in a marked rise in internal financing, the volume of which – at EUR 20.9 billion – was 10% higher in 2011 than in 2010 (see chart 7, right-hand panel). As internal financing options improved, companies required less external financing: According to the financial accounts, the volume of external financing was EUR 15.4 billion¹ in 2011, which is about one-third below the comparable 2010 figure and corresponds to just around one-quarter of the 2007 figure. Debt still accounted for a large share of corporate financing in 2011, contributing 57% to the external financing volume (down from more than 90% in 2010). At the same time, the corporate sector posted a surplus for the third time in a row, which stood at EUR 5.8 billion, up by EUR 1.2 billion from 2010.

Bank Loans Gained Importance in Corporate Financing

Lending by domestic banks accounted for around one-fourth (26%) of external financing of nonfinancial corporations in 2011, after a low of 7% had been reached in 2010.² Unlike in the euro area as a whole, the growth of bank loans to the corporate sector in Austria accelerated somewhat in the first months of 2012. According to the MFI

balance sheet statistics, the annual rate of change in Austrian bank lending (adjusted for reclassifications, valuation changes and exchange rate effects) was 2.9% in April 2012. By contrast, in the euro area, this rate slowed from 2.0% in October 2011 to 0.5% in April 2012.³ Lending at longer maturities (more than 5 years) continued to record stable growth in Austria, whereas the growth of loans with a maturity of less than 1 year declined in the first months of 2012.

The volume of loans taken out from foreign banks contracted by EUR 1.1 billion and came to EUR 11.8 billion in 2011 (this compares with EUR 155.3 billion in loans extended by domestic banks) after having risen steadily for four consecutive years. Taken together, Austrian and foreign bank lending accounted for about 18% of corporate external financing in 2011.

The slight tightening of credit standards for corporate loans observed in the second half of 2011 did not continue in the first months of 2012. The results of the Eurosystem's Bank Lending Survey (BLS) for Austria indicate that banks' credit standards for corporate customers remained unchanged in the first quarter of 2012. The results of enterprise surveys confirm that access to loans became somewhat more difficult in late 2011 and early 2012 and has stabilized since then. For instance, in the November 2011 and February 2012 waves of the WIFO Business Cycle Survey, around one-third of responding companies said that banks were restrictive when approving loans, while less than one-tenth thought they were

No further tightening of credit standards in the first quarter of 2012

Moderate rise in bank lending

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

² At the cut-off date, financial accounts data were available up to the fourth quarter of 2011. Therefore, the figures on growth contribution presented here refer to 2011. More recent developments of financing flows are discussed using data from the MFI balance sheet statistics and securities issues statistics.

³ For more information on current developments of bank lending to the corporate sector, see the OeNB's lending report (*Kreditbericht*, available in German only at www.oenb.de/img/kreditbericht_juni_2012_tcm14-248172.pdf).

accommodating. Of the companies that actually needed a loan in the three-month period prior to each survey, almost one-half said that banks' lending behavior was restrictive. The *Survey on the access to finance of SMEs in the euro area (SAFE)* for Austria reported similar results, with the share of companies that indicated their access to bank loans had deteriorated in the first quarter of 2012 being 15% higher than the share of those who registered an improvement in the availability of bank loans (this percentage was 12% for overdrafts).

At the same time, the banks surveyed in the BLS noted a slight decline in corporate loan demand for the fourth time in a row in the first quarter of 2012. Both large companies and small and medium-sized enterprises demanded less credit. This can be explained by somewhat lower funding requirements for fixed investment, mergers and acquisitions as well as corporate restructuring, and by the fact that companies increasingly relied on internal sources of finance.

Financing costs for loans were low until the first quarter of 2012: In response to the two ECB interest rate cuts of November and December 2011 (by 0.25 percentage points each) and the associated decline in money market rates, corporate lending rates fell by 62 basis points between October 2011 and April 2012 (this decrease was slightly more pronounced for loans with a volume of more than EUR 1 million than for smaller loans). The noninterest components of loan conditions, which had been tightened somewhat in the second half of 2011 (above all for loans to large companies), remained unchanged in the first quarter of 2012.

Bond Financing Still on the Rise

In 2011, bond issues of EUR 6.2 billion accounted for 40% of Austrian companies' financing, which is an above-average share compared with previous years. Net new bond issuance thus outpaced new bank lending by more than one-half that year. So far in 2012, bond issuance has remained strong. At an annual growth rate of 7.5% (according to securities issues statistics), the expansion rate of corporate bonds markedly exceeded that of other financing instruments in March 2012. The share of variable rate bonds hovered around 12% to 13% in the second half of 2011 and the first months of 2012, while the proportion of bond issues in foreign currency continued to decrease from mid-2011 and stood at 9.1% in March 2012.

Bond yields, like lending rates, contracted in the first months of 2012; their decline was even considerably more pronounced than that of lending rates. After a marked increase in yields for lower-rated bonds in the second half of 2011 due to investors' lower risk appetite, the yields on BBB-rated bonds dropped by 157 basis points in the first five months of 2012, reaching 4.67% in May 2012.⁴ In the same period, the yields on AAA-rated corporate bonds declined by 127 basis points, and the yield spread between BBB issues and top-rated euro-denominated corporate bonds narrowed from 282 to 252 basis points, the lowest value recorded since August 2011. Bond yields were more than 4 percentage points below the peak values observed at the height of the financial market turmoil in the fall of 2008.

Bonds account for a sizable portion of external financing

Lending rates decline

⁴ Euro area figures are used here, as no time series is available for yields on Austrian corporate bonds.

Slowdown in equity financing growth

Marked Decline in Intrasector Financing

Despite a marked decrease in (domestic) intrasector financing flows – which include trade credit by domestic companies, intracompany financing (including loans between affiliated enterprises) and other forms of financing between companies – still accounted for around one-sixth of corporate external financing in 2011. The net volume of trade credit by domestic companies decreased, vigorous sales and the low interest rate

level notwithstanding, and intragroup financing flows dropped by more than two-thirds.

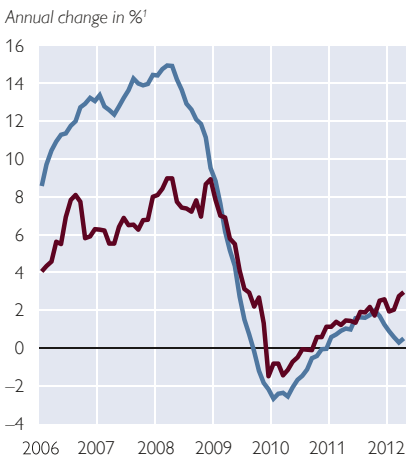
Equity Financing Still Affected by the Crisis

Equity financing continued to be hampered by the crisis in 2011, with quoted stocks accounting for just a little over 6% of external financing for nonfinancial corporations. After increasing temporarily in the second quarter of 2011, the amount of capital raised on the stock

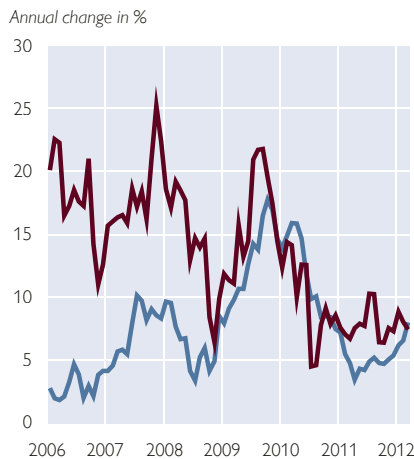
Chart 8

Volumes of and Conditions for Key Elements of Nonfinancial Corporations' External Financing

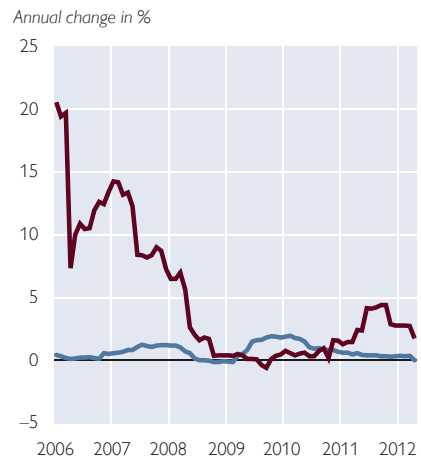
Loans: Volumes



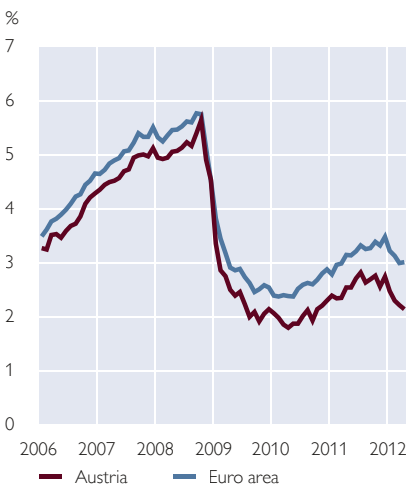
Bonds: Volumes



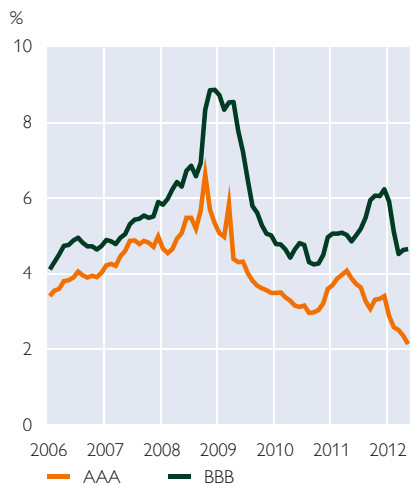
Quoted Stocks: Volumes



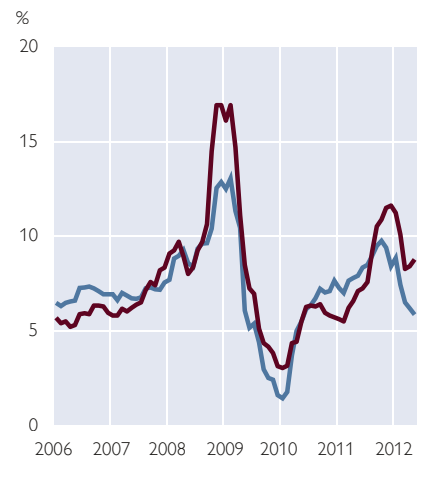
Loans: Interest Rates



Bonds: Yields



Quoted Stocks: Earnings Yields



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

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

exchange declined markedly in line with falling stock prices and – owing to a few small delistings – was even slightly negative in net terms in the first four months of 2012.

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 8.8 in May 2012 after the sharp decline in stock prices observed in the second half of 2011 subsided and was even partly reversed.

At EUR 5.5 billion, over-the-counter equities accounted for roughly one-third of external financing in 2011. In total, corporations obtained 43% of their external financing in the form of equity that year. Relative to the corporate sector's total liabilities, its equity position (i.e. the proportion of shares in total liabilities) decreased from 43.1% to 41.4% in 2011. This slight decline was mainly caused by a decline in equity (in accounting terms) due to lower stock prices, as public equity – in line with international standards – is always valued on a marked-to-market basis in the financial accounts. Excluding this effect, the Austrian corporate sector's equity position would have remained unchanged in 2011.

Companies' Debt Servicing Capacity Remains below Pre-Crisis Levels

The growth rate of corporate debt (in terms of total loans and bonds) slowed gradually in 2011 and stood at 2.3% in the fourth quarter of the year, but in light of weaker corporate earnings growth the ratio of corporate debt to profits no longer decreased in the second half of the year. At just under 270% of gross operating surplus, the debt ratio of the Austrian corporate sector was considerably higher than in the pre-crisis years, and it was also higher

than in the euro area as a whole. The debt-to-equity ratio of Austrian companies, too, was higher than in the euro area, which highlights the importance of debt financing in Austria. The sharp rise in the debt-to-equity ratio observed in the second half of 2011 – like the above-mentioned decrease in the equity position – was primarily attributable to a decline in equity losses (in accounting terms) caused by lower stock prices. Excluding this effect, the debt-to-equity ratio, too, would have remained unchanged in 2011.

Thanks to the subdued pace of loan financing and, even more, the consistently low level of loan rates, low corporate interest expenses helped contain corporate costs. In relation to gross operating surplus, interest expenses remained broadly unchanged in the second half of 2011, after they had increased somewhat in the first half of the year, mainly because of the slight rise in interest rates. However, even though corporate sector debt – and thus the sector's exposure to interest rate risk – increased only moderately during the crisis, a rise in interest rates might create a noticeable burden for highly indebted companies. This aspect is especially relevant in light of the above-average share of variable rate loans in Austria. Compared with their euro area peers, Austrian companies have had markedly lower interest expenses in low-interest periods, but their exposure to interest rate risk has been considerably higher. The share of foreign currency loans to companies is currently almost twice as high in Austria as in the euro area, but it has been very stable over the past few years, and it is significantly lower than the share of foreign currency loans in total loans to the household sector.

The rather slow rise in debt financing and the low interest rate level (which

Corporate equity position remains stable

Variable rate loans imply interest rate risk

Stable debt ratio

Number of insolvent companies continues to decline

Saving ratio declines

makes debt servicing easier even for highly indebted companies) in combination with favorable economic developments in 2011 have contributed to the fact that the number of corporate insolvencies rose relatively moderately during the crisis and has even declined since mid-2010. Based on the total of the preceding four quarters to adjust for seasonality, the number of insolvencies recorded in the first quarter of 2012 was 8.3% lower than the 2011 figure; it also dropped markedly in relation to the number of companies.

Households Suffer Considerable Valuation Losses on Financial Assets

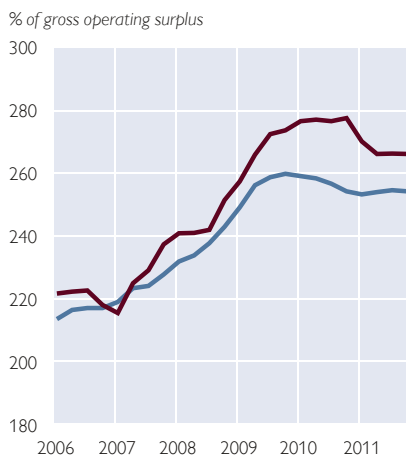
Real Income Down

Household disposable income increased noticeably in nominal terms in 2011, but declined slightly in real terms owing to the elevated inflation rate, even though household income was supported by positive labor market dynamics through to the first quarter of 2012. Consumer spending rose modestly but at a faster rate than income. As a result, the saving ratio declined again, for the fourth year

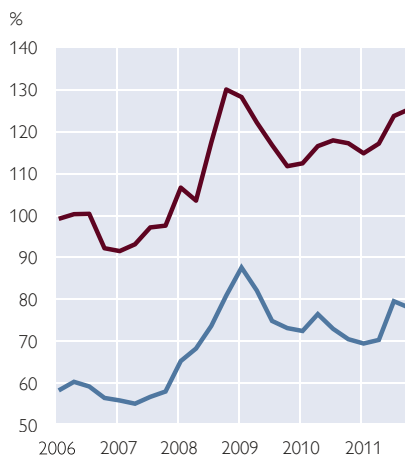
Chart 9

Risk Indicators of Nonfinancial Corporations

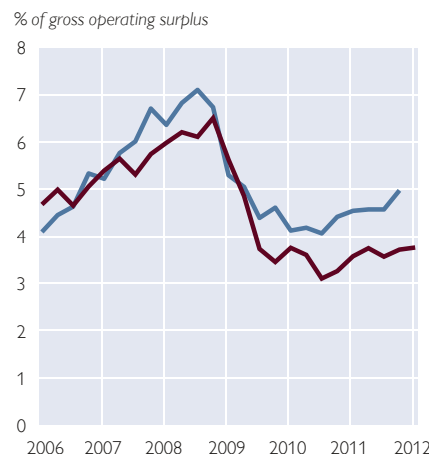
Debt



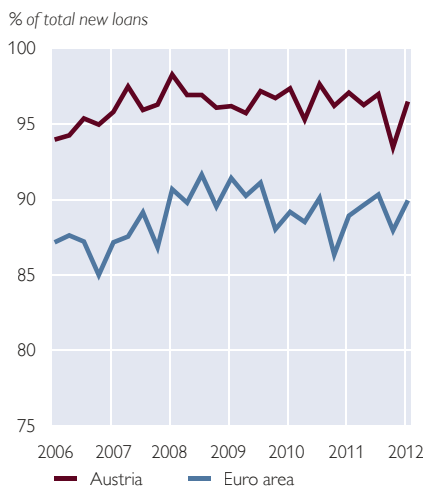
Debt-to-Equity Ratio



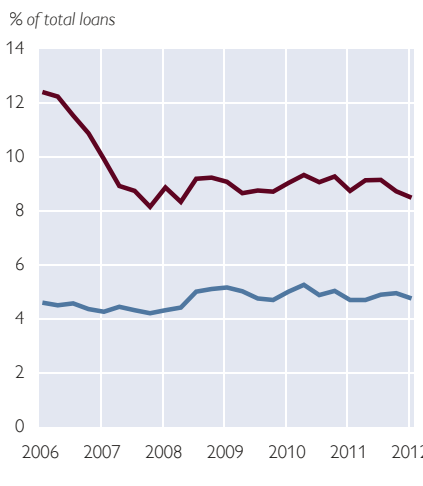
Interest Expense



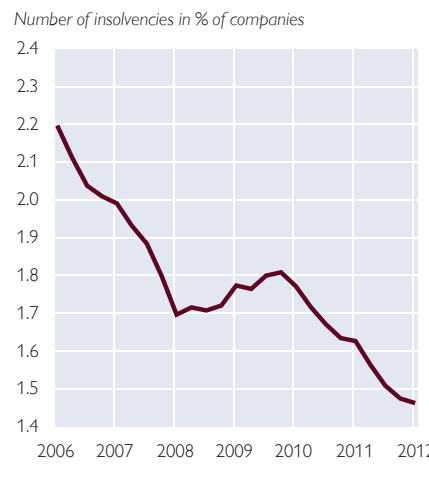
Variable Rate Loans



Foreign Currency Loans



Insolvencies



Source: OeNB, ECB, Eurostat, KSV 1870.

in a row, and came to 7.5% in 2011; since 2008, the saving ratio has dropped by more than 4 percentage points. This decline is likely connected to the structure of household income, among other things. Since the onset of the crisis, household income growth has been primarily driven by compensation of employees (i.e. the income component most likely to be spent), whereas investment income still contracted somewhat in 2011.

Household Financial Investment Halved during the Crisis

In step with the saving ratio, household⁵ financial investment continued to decline in 2011. At EUR 9.8 billion, it was 21% below the value recorded in 2010 and 54% below the pre-crisis peak value recorded in 2007.

Deposits accounted for roughly one-half (EUR 4.2 billion) of financial investment in 2011, but their growth remained slow at 2.0%. The largest inflows were recorded for overnight and short-term deposits, whereas the volume of long-term deposits declined in 2011 and the first quarter of 2012. A breakdown by types of deposits illustrates this development: Demand deposits accounted for almost 60% of new deposits, time deposits contributed just under 25%, and savings deposits accounted for only 17% (even though their share in total outstanding deposits is almost three-quarters). Excluding the interest accrued and credited to savings deposits at the end of the year, the volume of savings deposits would have contracted in 2011. This shift in the maturity structure suggests that households have a high preference for liquidity, and it might also be connected to low opportunity cost due to low interest rates.

In light of lingering uncertainty in financial markets, capital market investment by Austrian households remained well below the comparable figures of 2010. At just under EUR 0.5 billion in 2011, capital market investment contributed only around 5% to households' financial investments; its growth rate slowed from 5.2% to 0.5%. Debt securities posted rather high growth in 2011, whereas mutual fund share holdings dropped in net terms owing to the sharp decline in stock prices, and the growth of investment in quoted stocks lost considerable momentum.

Investment in life insurance and pension funds, too, rose considerably more slowly in 2011 (2.7%) than in 2010 (4.7%). As in the preceding years, it still had a stabilizing effect on financial investment, though, accounting for around 28% of total financial investment in 2011. 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 decision that had been made earlier. Demand for funded pension instruments is a key factor in this context. Moreover, in Austria, life insurance policies are often used as repayment vehicles for foreign currency bullet loans.

Even though Austrian households increased their financial investments by a net amount of EUR 9.8 billion, their financial assets were EUR 41 billion down compared to 2010, amounting to EUR 468.7 billion at end-2011. This discrepancy largely reflects substantial (unrealized) valuation losses in households' portfolios, which came to EUR 7.2 billion and thus accounted for roughly three-quarters of new financial investment in 2011. In relative terms, the prices of quoted stocks and mutual

Capital market investment growth slows markedly

Stabilizing effect of investment in life insurance

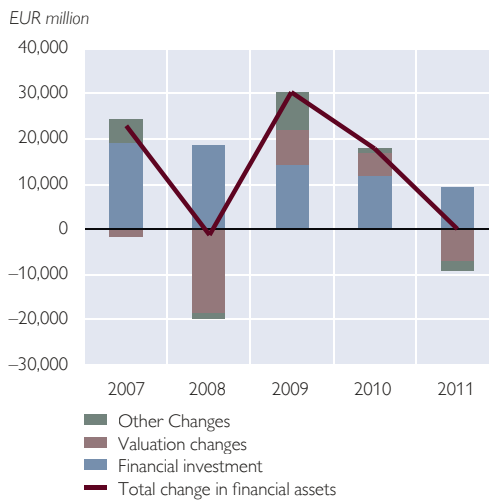
Slow deposit growth

Considerable unrealized valuation losses

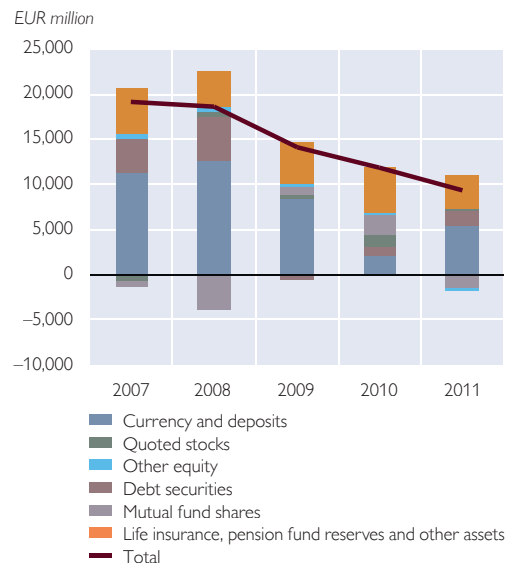
⁵ Nonprofit institutions serving households are not included here.

Changes in Households' Financial Assets

Determinants of Changes in Financial Assets



Components of Financial Investment



Source: OeNB.

fund shares declined most sharply (–23% and –5.3%, respectively, from end-2010), but debt securities suffered valuation losses, too.

Lending Growth Fueled by Housing Loans

According to Austria's financial accounts, bank loans made up slightly more than 85% of households' financial liabilities at the end of 2011. Growth in bank lending to households was relatively subdued in 2011 and so far in 2012. In April 2012, bank loans to households (adjusted for reclassifications, valuation changes and exchange rate effects) increased by 1.4%.

A breakdown by currencies shows a considerable rise in euro-denominated loans (April 2012: +5.2%) and a marked decline in foreign currency loans (–7.7%). This 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. A breakdown by loan purpose based on April 2012 data reveals a decline in consumer loans (–2.6% against the previous year) and other loans (–1.4%) as well as gains in housing loans (+3.7%). According to Bank Lending Survey results, banks' credit supply continued to be stable in the first quarter of 2012, as it had been over the past almost two years, whereas credit demand in the housing loan segment seems to have picked up somewhat in 2011. Other housing indicators are also pointing to a rise in credit demand. While no current data are available on newly completed housing projects, the rising number of residential building permits (+9.6% year on year in 2011) suggests a marked upturn in construction activity. At the same time, households needed more funding to purchase real estate, as housing prices have been on the rise in Austria (+5.5% year on year in 2011).

Loan conditions remained favorable, even though the two key interest

Foreign currency loans decline adjusted for exchange rate changes

Financing conditions still favorable

rate cuts of November and December 2011 (by a total of 50 basis points) and the associated decline in money market rates have not been fully passed through to retail rates. In April 2012, interest rates on new housing loans stood at 2.79%, which is 0.25 percentage points lower than the value recorded in October 2011. In the same period, interest rates on consumer loans dropped by 19 basis points to 4.95%. As a result, interest rates were 2.8 percentage points (housing loans) and 1.9 percentage points (consumer loans) below their pre-crisis levels.

Households' Currency and Interest Rate Risks

Austrian household debt (in absolute numbers) has been low by international comparison and remained relatively stable during the crisis thanks to moderate borrowing and the low interest rate level. At end-2011, total household liabilities stood at EUR 167 billion according to the financial accounts, up by 1.9% from a year earlier. As a percentage of net disposable income, household debt amounted to 90.7% (–0.7 percentage points from end-2010). The debt ratio of households in Austria

Household debt increases moderately

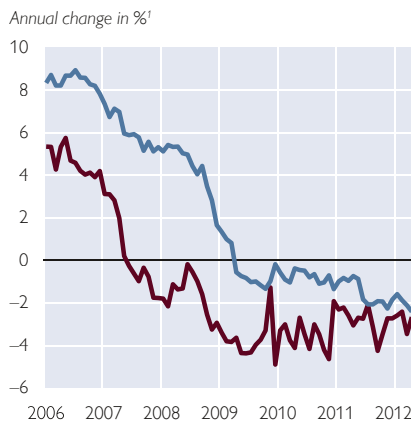
Chart 11

Volumes of and Conditions for MFI Loans to Households

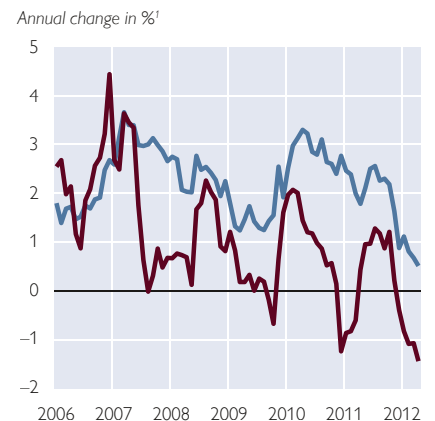
Housing Loans: Volumes



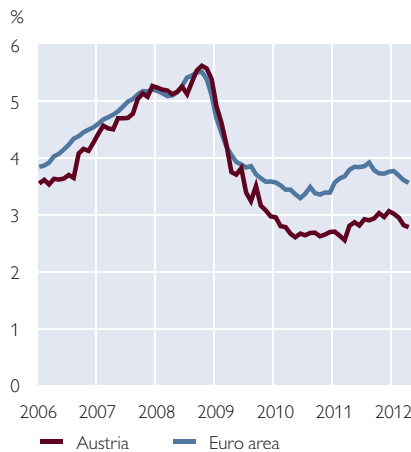
Consumer Loans: Volumes



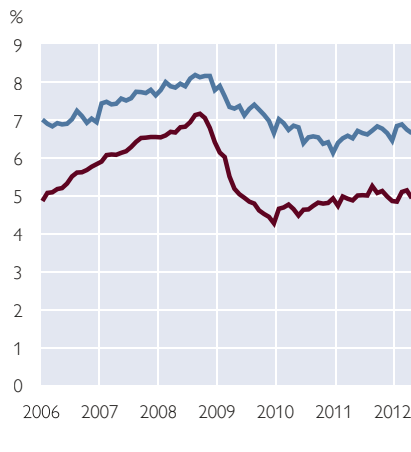
Other Loans: Volumes



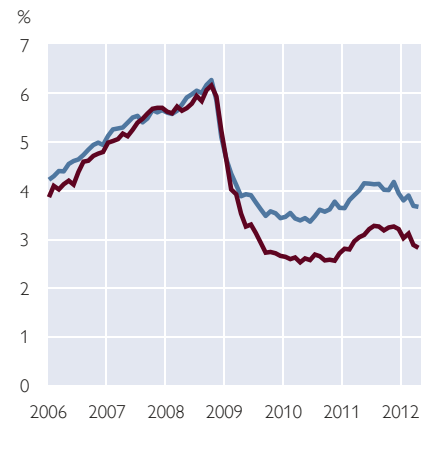
Housing Loans: Interest Rates



Consumer Loans: Interest Rates



Other Loans: Interest Rates



Source: OeNB, ECB.

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

Low interest expenses

thus continued to be lower than in the euro area as a whole (107% in the third quarter of 2011).

Owing to a combination of moderate debt levels and low interest rates, household interest expenses remained low. After having increased markedly in the third quarter of 2011, interest expenses declined again somewhat in the following two quarters on the back of reduced interest rates. As a percentage of disposable income, interest expenses averaged 2.3% in 2011, which

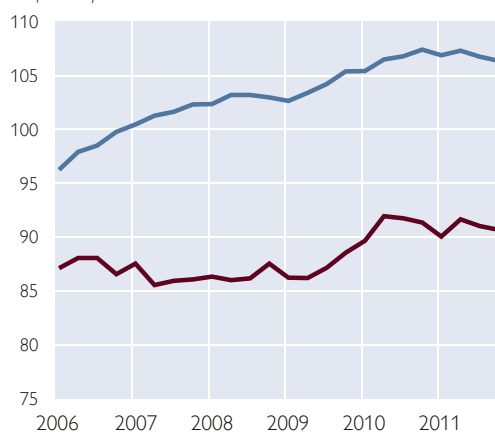
is around 1½ percentage points lower than before the onset of the crisis three years ago. One factor that contributed to this decline was the high share of variable rate loans: In the first quarter of 2012, 85.3% of new loans were granted with an initial rate fixation period of up to one year, which 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

Chart 12

Household Risk Indicators

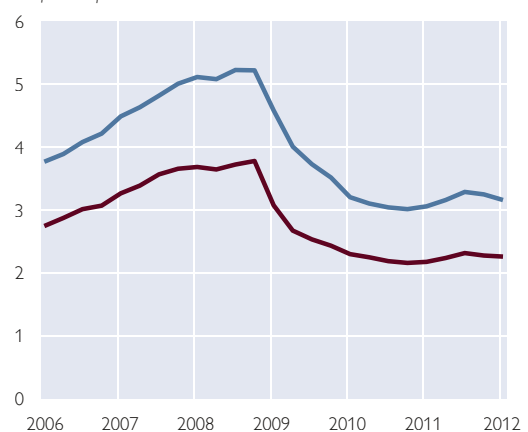
Liabilities

% of net disposable income



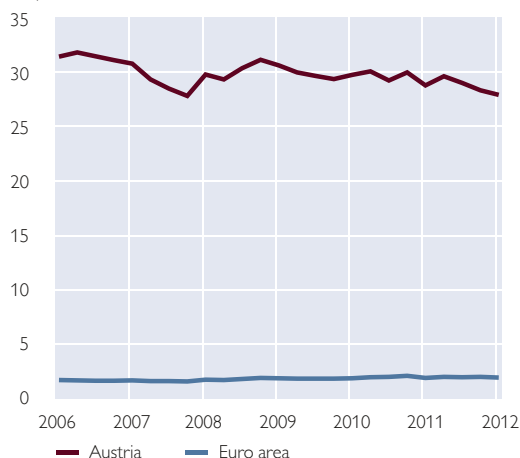
Interest Expense

% of net disposable income



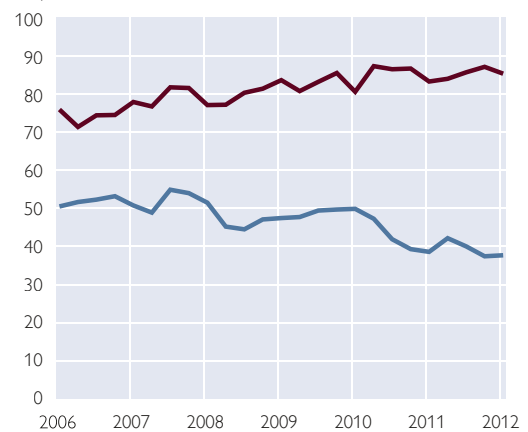
Foreign Currency Loans

% 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 expense on euro-denominated loans.

area; in addition, retail rates in Austria have generally been lower than in the euro area in recent years. Rising interest rates would have the opposite effect on interest expenses, though.

The sustained high proportion of foreign currency loans in total loans is another risk factor for the financial position of Austrian households. In the first quarter of 2012, 27.9% of the total

loan volume to Austrian households was still denominated in foreign currency. While this is 2.7 percentage points less than two years earlier, households are still exposed to substantial exchange rate risk (even though the Swiss franc has not appreciated further against the euro since September 2011, when the Swiss National Bank set a maximum exchange rate of CHF 1.20 to the euro).

Share of foreign
currency loans
declines somewhat