

Decline in Real Economy's Financing Volumes

Corporate Financing Still Affected by the Crisis

Economy Improves in the Second Half of 2009

After contracting for four quarters, the Austrian economy visibly improved in the second half of 2009. Among other factors, the rapid recovery of the world economy and the economic stimulus packages introduced in Austria (as in many other countries) contributed to this phenomenon. Positive impetus for the economy also came from the inventory cycle while investment in equipment continued to stagnate given low production capacity utilization.

Corporate profit momentum slowed markedly owing to the economic downturn in the first half of 2009. In the second quarter of 2009, the gross operating surplus of nonfinancial corporations (including mixed income of the self-employed) was 12% below the comparable figure a year ago.

Sharp Slowdown in Lending Momentum

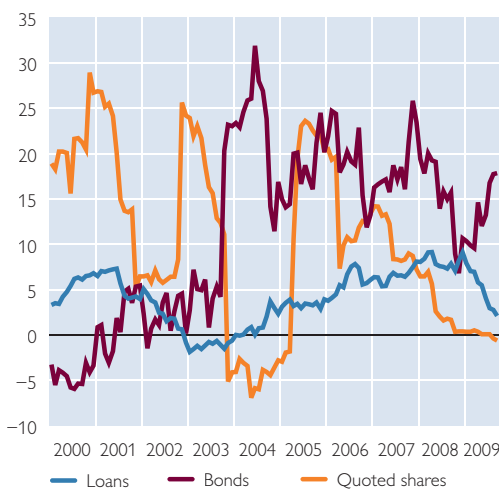
In the first half of 2009, the total external financing of the corporate sector (according to national financial accounts) fell by some two-thirds to EUR 4.8 billion compared with the first six months of 2008. This decline was primarily attributable to bank lending. While 60% of external financing came from bank loans in the second half of 2008, in the first six months of 2009 its growth contribution was negative. The growth of bank lending to the corporate sector slowed steadily during 2009. At 2.1% (adjusted for reclassifications, changes in valuations and exchange rate effects), the annual rate of change fell to its lowest level in five years in September 2009, according to MFI balance sheet statistics.¹

This slowdown in corporate lending is likely to have both supply- and demand-side causes. First, this decline corresponds to the historical pattern whereby corporate financing requirements decrease in periods of shrinking corporate investment. Second, banks have steadily tightened their credit standards since the start of the crisis. According to the Austrian results of the Eurosystem's bank lending survey, credit standards for corporate clients had tightened eight times in succession since the start of the crisis until they remained unchanged in the third quarter of 2009. Furthermore, the conditions and terms for approving loans – interest margins, collateral requirements, the size and maturity of loans granted, the loan covenants as well as the noninterest rate charges – were all markedly tightened during this period. Continued adverse refinancing conditions in the money markets and bond markets, as well as bleaker economic

Chart 17

Key Elements of External Corporate Financing

Annual change in %



Source: OeNB.

¹ For the development of bank loans, see the OeNB's Kreditbericht (available in German only).

prospects and more selective ratings contributed to this more restrictive credit policy. In a special quarterly survey on credit financing conditions conducted by the Austrian Institute for Economic Research (WIFO), enterprises reported likewise.

In contrast, lending rates have plummeted since November 2008 on the back of hefty key policy interest rate cuts by the ECB. In September 2009, interest rates for new loans to nonfinancial corporations up to EUR 1 million stood at 2.43% and for loans over EUR 1 million, at 2.05%, i.e. in both cases more than 3½ percentage points lower than in October 2008.

In addition to monetary policy, economic policy action also improved corporate financing conditions. The federal government's economic stimulus packages include some measures that aim to cut financing costs via guarantees and low-interest loans totaling EUR 800 million.² According to WIFO calculations, the financing costs for capital formation would thus be cut by 0.21 percentage points in both 2009 and 2010.³ Enabling the federal government to grant guarantees for large companies, the Act on Strengthening Company Liquidity (Unternehmensliquiditätsstärkungsgesetz or ULSG) aims less at cutting financing costs and more at facilitating companies' access to credit.⁴ The guarantee limit per company is a maximum of EUR 300 million over a period no longer than five years. The total amount of guarantees assumed, which can be used on a

revolving basis, is limited to EUR 10 billion.

Further Increase in Bond Financing

Unlike the slowdown in bank lending, the issuance of bonds by Austrian companies showed strong momentum in 2009. In the first half of 2009, about 50% of the corporate sector's external financing came from bond issues. In September 2009, the annual growth of corporate bonds was 17.9%, according to securities issues statistics. A large portion of bond issues were placed by quasi-public enterprises.

This dynamic development was considerably supported by the substantial improvement in the terms of bond issues, which had markedly deteriorated in fall 2008 owing to the sharp increase in investors' risk aversion induced by the financial crisis. Risk premiums have so far narrowed considerably in 2009. Between end-2008 and October 2009, yields on BBB-rated bonds fell from 8.9% to 5.3%.

Financial Crisis Brings Equity Financing to a Halt

Companies are still finding it difficult to gain access to financing via the stock exchange, which dried up almost completely during the crisis. In net terms (including delistings), new issues in the first nine months of 2009 were even negative. Although some companies carried out capital increases on the stock exchange in fall 2009, nonfinancial corporations did not launch any new issues.

² The increase in the guarantee limits of *austria wirtschaftsservice* (aws) will support additional loans of EUR 400 million, the ERP Fund's budget for low-interest loans was raised by EUR 200 million per year, and the European Investment Bank provides additional financial funds of EUR 200 million specially for SMEs.

³ Breuss, F., S. Kaniovski and M. Schratzenstaller. 2009. *Gesamtwirtschaftliche Auswirkungen der Konjunkturpakete I und II und der Steuerreform 2009*. Austrian Institute for Economic Research (WIFO). August.

⁴ The target group of these measures is companies with more than 250 employees, a turnover of more than EUR 50 million and a healthy economic basis prior to the crisis.

As investors' risk aversion has decreased markedly on the previous year, stock prices on the Vienna stock exchange and in international stock markets have risen markedly since the second quarter of 2009, thereby improving the terms for raising capital on the stock exchange. Between the end of the first quarter of 2009 and November 13, 2009, the ATX climbed by 55% although corporate profits were down. The price-to-earnings ratio (P/E ratio), which at times had fallen to 5.9 (November and December 2008) during the crisis, reached a new record high of 24.1 in October 2009. Accordingly, the earnings yield (inverse of the P/E ratio) has fallen visibly (to 4.1 at the last count).

Owing to the shortage of other forms of external finance, more than half of the corporate sector's external financing came from non-stock market forms of capital injection; although, at EUR 2.6 billion, the latter amounted to less than 50% of the comparable level a

year ago. Overall, companies raised about 52% of external financing in the form of equity in the first half of 2009, which was somewhat more than in previous years (2003–2008 average: 43%). The share of equity in the corporate sector's total liabilities, which had fallen from 55% to 45% between mid-2007 and end-2008, rose modestly to 45.6%, which was attributable to the higher market value of the quoted stocks as well as to the higher share of capital raised.

Increasing Debt Ratio

Even though the absolute level of corporate debt did virtually not change in the first half of 2009, debt indicators did deteriorate markedly. Owing to the slide in corporate profits, the ratio of debt to profits abruptly rose in the first two quarters of 2009 (from 209% to 223% of gross operating surplus). In relation to GDP, the debt ratio increased by a similar extent (from 84% to 86%).

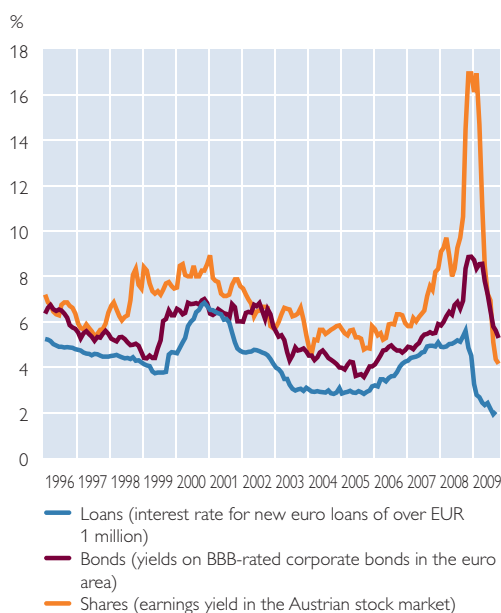
However, corporate debt in Austria was below the euro area average and started to rise here later than in the euro area as a whole, where debt has been on the rise since 2005.

Steady Rise in Corporate Insolvencies

Insolvency statistics clearly mirrored the economic downturn. In the first three quarters of 2009, the number of insolvencies increased by 10.5% year on year. Export-led industries suffered a particularly high increase while the construction industry, for instance, registered a well below-average rise. In addition, average liabilities per insolvency event were 32% higher than in the first three quarters of 2008. As a result of both these factors, total estimated insolvency liabilities rose by 45%. In relation to the total liabilities

Chart 18

Corporate Financing Conditions

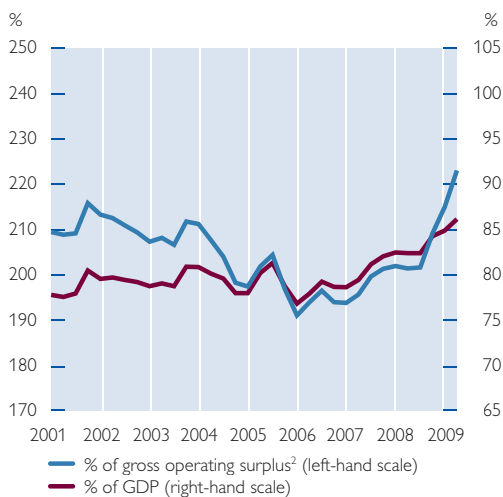


Source: OeNB, Thomson Reuters, Wiener Börse AG.

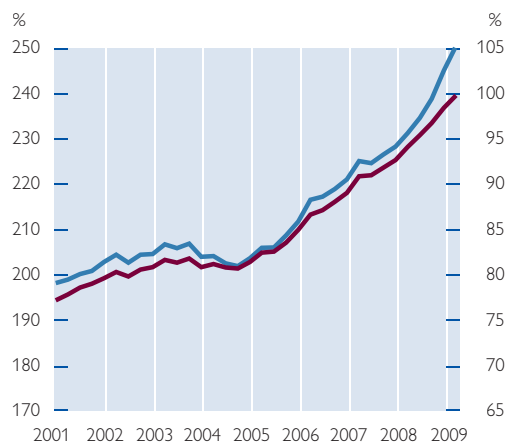
Chart 19

Corporate Sector Debt¹

Austria



Euro Area



Source: EZB, OeNB.

¹ Short-term and long-term loans, short-term and long-term debt securities.

² Including mixed income of the self-employed.

of the corporate sector (according to national financial accounts), insolvency liabilities rose from 0.59% in the fourth quarter of 2008 to 0.81% in the third quarter of 2009 (in both cases, the average of the previous four quarters).

Compared with the euro area average, the increase in corporate insolvencies in Austria was still comparatively modest – at least in 2008. While insolvency numbers in Austria remained virtually unchanged in 2008 (+0.3% year on year), in the euro area they were up by 14%.⁵

Since the development in corporate insolvencies is usually a lagging economic indicator, insolvencies cannot be expected to fall immediately in the event of an economic upturn. Just as companies were less affected by payment delays on the part of their customers in the recent economic boom years, this development could be reversed with the increase in insolvencies.⁶ Insolvencies are not only important for the insolvent companies in question but also in respect of other companies' financial situation. Customer payment delays and/or defaults can reduce the liquidity of companies thus affected and result in insolvencies. This means that also sectors that are not directly export-led may be more

Chart 20

Development of Corporate Insolvencies

Moving four-quarter averages, annualized

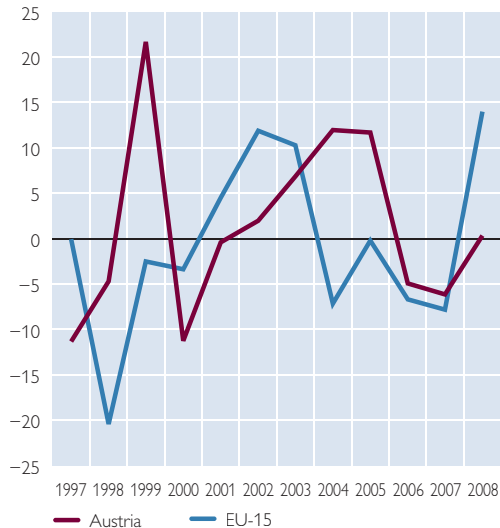


Source: Kreditschutzverband von 1870, OeNB.

Chart 21

International Comparison of Corporate Insolvencies

Annual change in %



Source: Kreditschutzverband von 1870, Creditreform, Euler-Hermes.

and more affected by insolvencies. As early as 2008, the main causes of insolvencies were increasingly external sources of loss such as a changed market situation, the insolvency of customers or the default of suppliers.

Conclusion: Only Slight Easing So Far on the Financing Side

The financial crisis is still impairing the financing of Austrian companies although the situation has eased slightly compared with six months ago. Monetary policy (in the form of lower inter-

est rates), economic policy (via guarantees and assumptions of liability) and capital markets (via lower risk premiums) have helped considerably improve financing conditions.

However, companies' access to financial funds has not improved to the same extent. Raising capital in the stock market is still barely feasible. Although banks do not seem to have further tightened lending latterly, they have to a greater extent been factoring borrowers' risk-bearing capacity and economic prospects into their lending decisions. Given the economic situation, access to financial funds has therefore become more difficult for many companies.

Even though debt did not rise very steeply (and is still not very high by international comparison) in absolute terms, it increased in relation to the performance of companies and the economy as a whole owing to slowing profit momentum and a decline in GDP (even though currently low interest rates are restraining the related costs). The corporate sector's lower creditworthiness is also reflected in the growing number of corporate insolvencies. However, it is unlikely to have been the sole factor responsible for the slowdown in bank lending in 2009 but, in view of the decline in investment, probably also had demand-side causes.

⁵ EU-12 since a continuous time series is not available for countries which subsequently joined the euro area. Comparable international values are only available for annual data. Since insolvency numbers per country differ widely, the rate of change was not calculated on the basis of the total amount of insolvencies in individual countries but on the basis of the change in individual countries weighted with the percentage share of GDP. An international comparison of absolute insolvency numbers is impractical owing to the extremely heterogeneous state of affairs in relation to insolvency law and the survey methods of insolvency statistics.

⁶ The share of companies affected by customer insolvencies continued to decline in 2009, according to the Austrian credit monitoring agency Kreditschutzverband von 1870 (KSV). The latest KSV survey revealed that only 48% of companies suffered losses through insolvencies in 2008. In 2009, furthermore, companies' delay in paying accounts receivable was shortened to only seven days.

Reduced Debt-Servicing Capacity of the Austrian Household Sector⁷

Labor Market Still Tight Slack

Despite first signs of economic recovery, the Austrian labor market situation has continued to worsen. In the period from the third quarter of 2008 to the third quarter of 2009, jobless numbers grew by 54,700. The unemployment rate (Eurostat definition) climbed from 3.9% in September 2008 to 4.8% in September 2009. However, private consumption – fueled by comparatively high wage settlements for 2009, easing inflation and the fiscal reform taking retroactive effect from the start of 2009 – had a stabilizing effect on aggregate demand.

Sluggish Credit Demand

New (MFI) loans to households remain in steep decline: Whereas growth prior to the onset of the crisis (in July 2007) amounted to 4.8% year on year, in

March 2009 it slowed to 1.2% and, most recently, to 0.3% in September 2009 (see chart 22). This slowdown was primarily attributable to consumer loans: new consumer lending has been down since the start of the crisis. Another contributory factor was housing loans, whose growth rates have steadily decelerated. Nevertheless, this development is less dramatic compared with the euro area, where household lending in September 2009 even fell slightly short of the comparable month a year earlier (–0.3%).

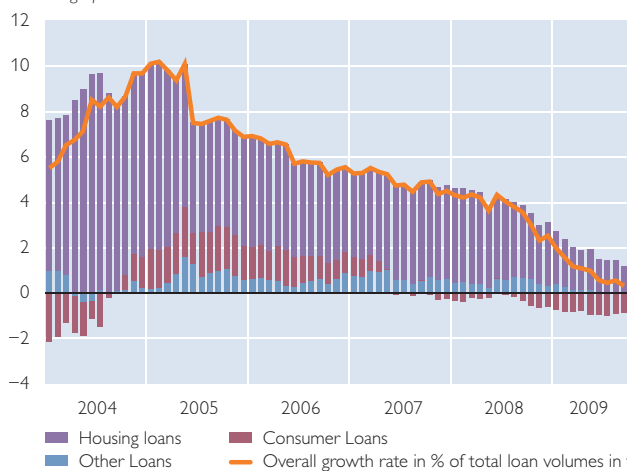
The slowdown in lending growth, which has been very marked since mid-June 2008 in particular, is likely to be primarily due to the development in demand. Various sentiment indicators show that consumer confidence plummeted during the global economic crisis. In addition, banks – according to the Bank Lending Survey (BLS) – suggest that the demand for household loans weakened slightly from the third

Chart 22

Growth Contributions of MFI Loans to Households

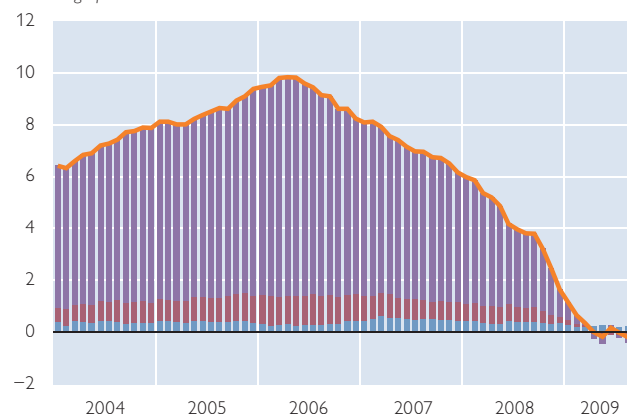
Austria

Percentage points



Euro Area

Percentage points

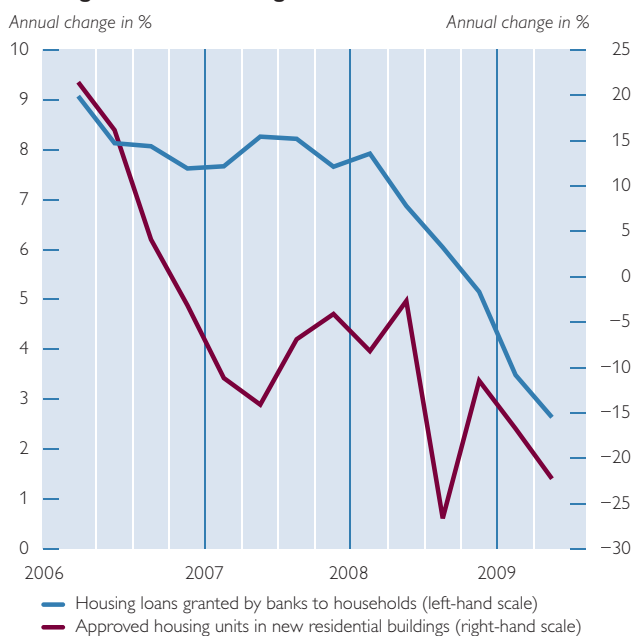


Source: OeNB.

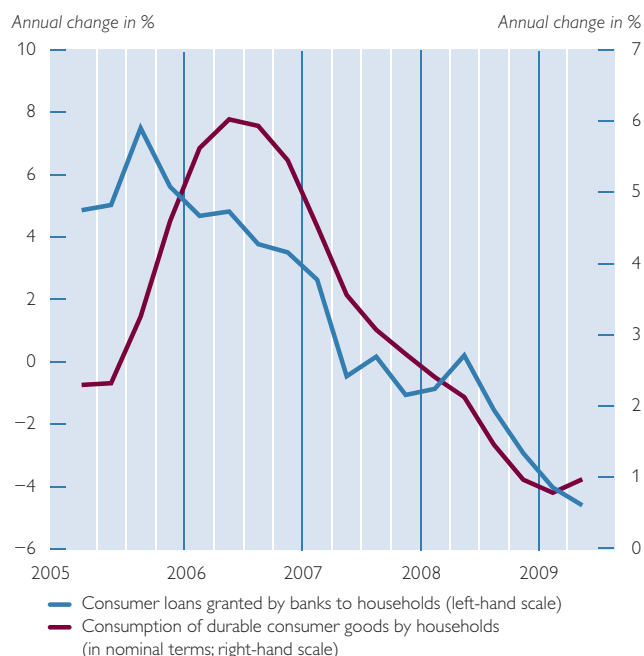
⁷ Unless otherwise indicated, the household sector also includes non-profit private organizations (e.g. trade unions, churches, foundations).

Demand for Household Loans

Housing Loans and Building Permits



Consumer Loans and Durable Consumer Goods



Source: OeNB, Statistics Austria.

quarter of 2008 to the first quarter of 2009. In addition, sluggish lending to households for house purchase has been accompanied in the last two years by a contraction in residential construction activity (see chart 23, left-hand panel). The number of permits for new residential units has been down since end-2006. In the second quarter of 2009, it was 22% lower than the same quarter a year ago. Consumer loans, which show a high positive correlation with demand for durable consumer goods (see chart 23, right-hand panel), show similar momentum.

Continued Safe Investment of Financial Assets

Chart 24 (left-hand panel) shows that Austrian households' total financial assets grew by 0.3% year on year in the second quarter of 2009 after having

fallen (in unrealized terms) in the previous two quarters. This modest recovery was primarily attributable to price gains in global stock markets. The situation however remains tight. For instance, owing to price effects, the household sector's assets invested in stocks had lost 42% in value (in unrealized terms) by the second quarter of 2009 compared with the same period a year ago. Likewise, the portfolio of mutual funds shares was 8% slimmer year on year.

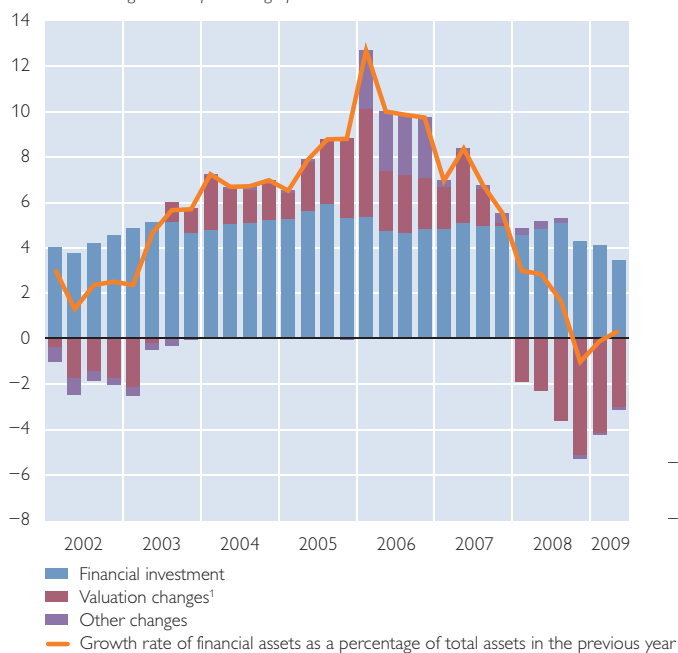
Both loan repayment vehicles (see box 1) and funded pension instruments were directly hit by (unrealized) capital market losses⁸. Chart 25 (right-hand panel) shows that the financial assets used for this kind of provisioning were subject to valuation losses in 2007 and 2008: in 2008, these assets shrank by EUR 1.9 billion (in unrealized terms)

⁸ Funded pension instruments include pension funds, severance funds and subsidized personal pension schemes.

Changes in Households' Financial Assets

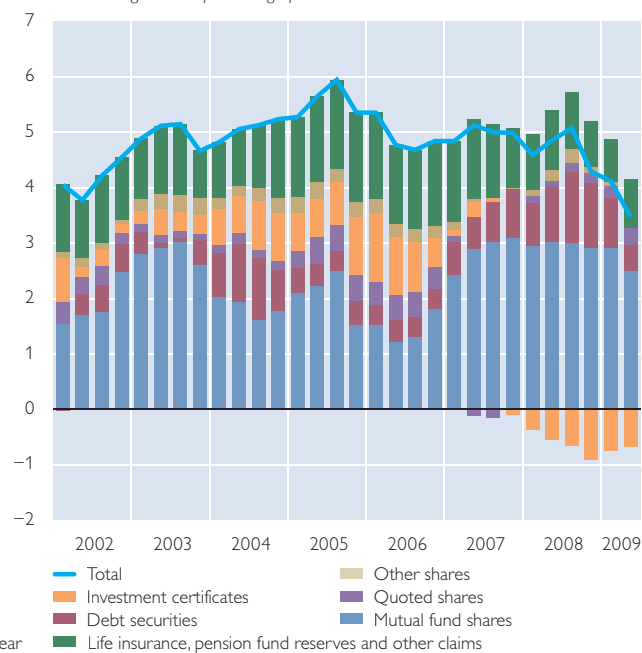
Changes in Financial Assets

Contributions to growth in percentage points



Determinants of Financial Investment¹

Contributions to growth in percentage points



Source: OeNB.

¹ Calculated on the basis of securities data for securities positions; calculated on the basis of stock changes and transactions for the remaining positions.

year on year. The same chart also shows that the importance of funded pension income steadily increased in recent years. Both the total contributions paid in and benefits paid out (by severance funds and pension funds) grew continuously, with the latter accounting for EUR 0.6 billion in 2008, i.e. almost 2.4% of public pension payments.⁹

Owing to capital market risks, the household sector has since mid-2007 reallocated its financial asset portfolio; these shifts had barely changed until recently (second quarter of 2009): currency/deposits and debt securities have replaced stocks, mutual funds shares and life insurances and pension fund investments as key components of finan-

cial investment (see chart 24, right-hand panel).

The household sector's real estate assets are even larger than its financial assets. According to the OeNB Household Survey on Housing Wealth 2008 (see box 1), total real estate assets of Austrian households¹⁰ ranged between EUR 690 billion and EUR 880 billion in 2007, i.e. between 62% and 68% of their total wealth. Accordingly, Austrian households' total wealth ranged between EUR 1,110 and EUR 1,290 billion in value.

Decline in Property Income

In the economy as a whole, income generated from investment accounts for a significant share of disposable income.

⁹ Subsidized personal pension schemes are not yet making pension payouts, as they have still not reached their minimum maturity of 10 years since their introduction.

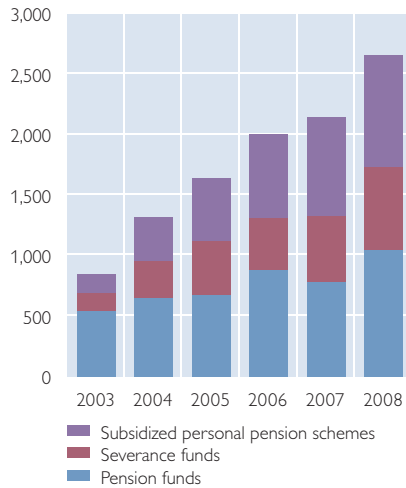
¹⁰ Non-profit private organizations (e.g. trade unions, churches, foundations) are not included here.

Chart 25

Funded Pension Instruments

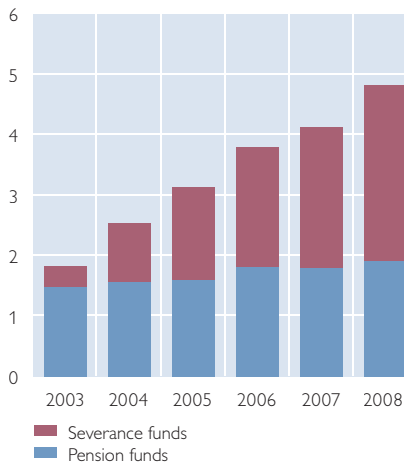
Pension Reserves

EUR million



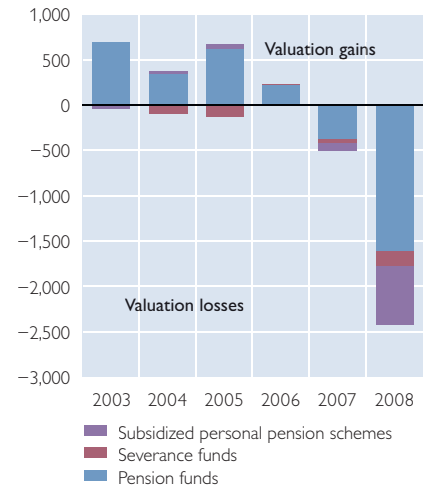
Pension Benefits

% of public pension payments



Valuation Changes¹

EUR million



Source: OeNB, Austrian Federal Economic Chamber, FMA.

¹ Defined as annual change in stocks less employer and employee contributions.

In previous years, a sizeable share of household real income growth came from growth in (gross) property income. However, chart 26 shows that property income growth has weakened

in recent years and, in the period from the third quarter of 2008 to the second quarter of 2009, even fell by 8% year on year. In 2008, the decline in property income attributable to policy in-

Chart 26

Property Income

Contributions to growth in percentage points



Source: Statistics Austria.

insurance holders was primarily responsible for this situation.¹¹ Although this measure is purely hypothetical (it reflects the investment results of insurance companies and pension funds but does not reflect real transactions with households), its development mirrors at least the increased risks to pension income from capital market investment in 2008.

Lower Interest Burden, Higher Income Risk

New Record High of Liabilities in Personal Bankruptcy Proceedings

In the third quarter of 2009, the up-trend in the number of personal bankruptcies continued, amounting to 2,521 new cases (0.12% of the Austrian population). At EUR 310 million (0.77% of households' total liabilities), the corresponding insolvency liabilities of the household sector reached a new record high. This development is partly attributable to the fact that an increasing number of debtors are making use of the opportunity to discharge their debts. Moreover, as insolvencies constitute a lagging indicator, it is likely that the number of insolvencies will rise even more strongly on the back of economic developments, since the mounting income risk, which is inherent in the economic crisis, also involves the risk of reducing households' debt-serving capacity.

Continued High Foreign Currency Share in Total Lending

Although the foreign currency share in total lending has fallen slightly since fall 2008 (from 31.3% of total loans in October 2008 to 30.2% in September 2009), owing to the fact that only lending in euro expanded in the last 12

months, and although high-income households account for the bulk of foreign currency loans (see box 1), it is still very high compared with the euro area, where it was 1.8% in September 2009. The related risks – primarily, the performance risk of the repayment vehicle, to which foreign currency loans are often linked – should therefore not be underestimated (see box 1).

Reduction in Interest Burden

The high share of variable rate loans in Austria (83% of new household loans in September 2009 compared with 49% in the euro area) means that banks' retail interest rates relatively quickly reflected the hefty key interest rate changes since October 2008. After the ECB cut its main refinancing rate from 3.75% to 1% between October 2008 and May 2009, actual interest rate cuts of 2.03 percentage points and 2.55 percentage points followed for housing loans and consumer loans respectively between September 2008 and September 2009. Interest rates for loans with an initial interest rate fixed for up to one year (i.e. variable rate loans) fell far faster than the average of all loans in the housing segment, in particular.

This decline visibly reduced households' interest expenses for loans: after amounting to 3.9% of disposable household income in the second half of 2008, in the first half of 2009 they were a mere 2.8%.

Lower interest expenses and the fact that variable rate (housing) loans are held by high-income households to a higher than average extent, the impact of households' interest burden on financial stability is likely to have lessened in the past six months.

¹¹ *The growth contributions for 2009 were not available before the cutoff date for data.*

OeNB-Survey on Housing Wealth and Housing Finance of Households

Not all households are in debt or have the same debt-servicing capacity. This is why disaggregated information about persons in debt (e.g. by income) and their level of debt are crucial for identifying financial stability risks, as made clear not least by the current crisis. In 2008, the OeNB therefore commissioned a survey on the housing wealth and housing finance of Austrian households, which represent the largest items in the assets and liabilities on households' balance sheet.¹

The survey data indicate that 22% of households have housing loans.² Compared with other European countries³, which have carried out similar surveys, this share is small however: The average share for all countries (including Austria) is 26%. The potential financial stability risks of housing debt in Austria is therefore concentrated only on a rather small group of households (0.7 of 3.5 million households), who are significantly more frequently young and have higher household incomes than owners or tenants that have not taken out housing loans.

In order to measure the debt-servicing capacity of these (housing)-indebted households, a number of different indicators such as the debt servicing ratio (debt servicing for housing loans as a percentage of households' disposable income) are used. The chart below (left-hand panel) shows that the share of households' debt burden is higher for households with low disposable income. The median household of the group with the lowest income uses 50% of its disposable income to repay its loan, which is relatively high compared with other European countries. However, another indicator (right-hand panel) shows that the related risks to financial stability are likely to be rather small, as the (housing) debt of this lowest income group accounts for a mere 9.5% of total housing loans.

Foreign currency loans can also impair households' debt-servicing capacity, as they bear various risks and are particularly popular in Austria. According to the OeNB's Household Survey on Housing Wealth 2008, 29% of all Austrian households with (housing) debt have foreign currency loans. These households are deep in debt to a higher than average extent compared with households without foreign currency loans, as such loans are often bullet loans. The fact that the largest share of households with loans linked to repayment vehicles relies on return on investment in the capital market – 60% have at least a life insurance policy as a repayment vehicle, 38% have at least a mutual fund and 4% at least stocks – means that repayment vehicles also involve the risk of securities speculation. However, these risks are limited to some extent owing to the fact that foreign currency loans are much more often taken out by high income households and that these households generally have a lower loan-to-value ratio, which means that if needed, banks would be able to cover their loans by adequate collateral.

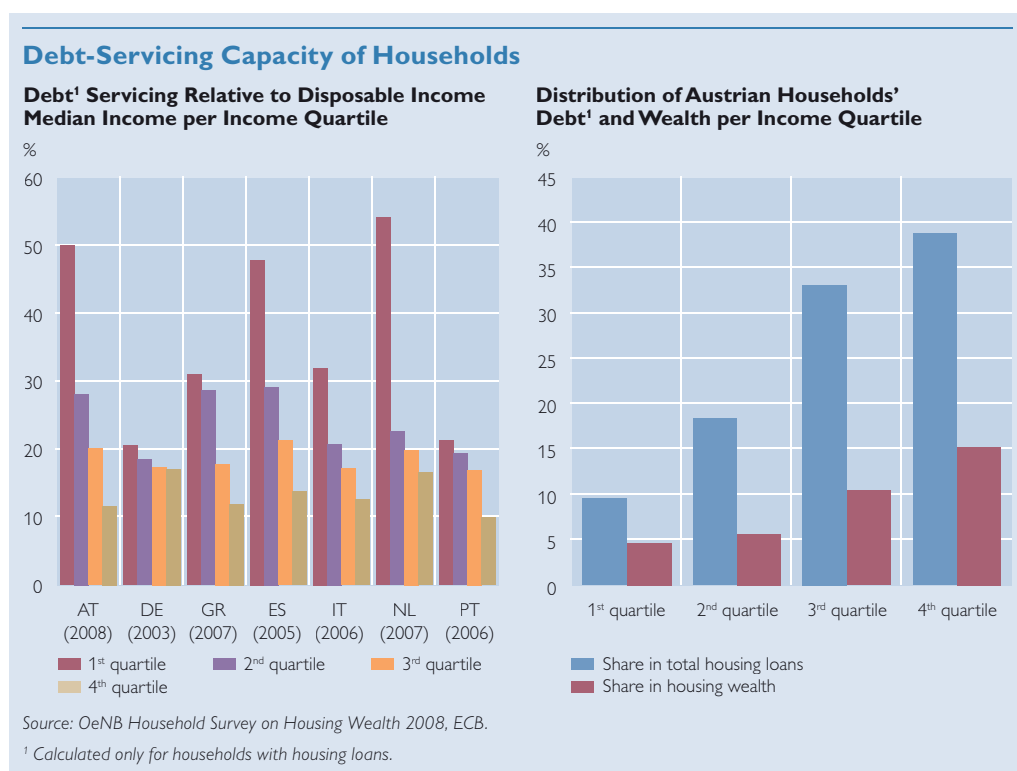
Last but by no means least, it should be pointed out that a complete analysis of financial stability risks is only feasible where data on households' total wealth and debt (not only those arising from housing) are available. This is why the Eurosystem intends to carry out on a regular basis over the next few years (every three years) an in-depth compilation of data on total household balance sheets and household expenditure.⁴ An international comparison and the analyses of a number of key research questions will be possible on the basis of these harmonized data.

¹ See Fessler P., P. Mooslechner, M. Schürz and K. Wagner. 2009. *Housing Wealth of Austrian Households*. In: *Monetary Policy & the Economy Q2/09*. OeNB. 104–124; and N. Albacete and K. Wagner. 2009. *Housing Finance of Austrian Households*. In: *Monetary Policy & the Economy Q3/09*. OeNB. 62–92.

² In this instance, the term "housing loan" covers only loans for the purchase of residential premises. Loans for the maintenance of residential premises, which are covered by national financial accounts, were not included in the survey.

³ Germany, Spain, Portugal, Greece, the Netherlands, Ireland, France and Italy.

⁴ HFCS: Household Finance and Consumption Survey.



Conclusion: Reduced Debt-Servicing Capacity

Despite initial signs of economic recovery, the Austrian labor market remains slack. For the household sector, this signifies that a high income risk that can impair households' debt-servicing capacity still exists. Low income Austrian households, which – even compared internationally – use a higher than average share of their disposable income for loan repayments appear to be especially exposed. The growing number of personal bankruptcies in

Austria and the decline in property income both underline this point.

By contrast, the interest burden was reduced by cuts in the ECB's key interest rate, which were largely passed on in bank lending rates, thereby lowering households' interest expenses.

Overall, however, the situation remains strained in the Austrian household sector, which in response is showing continued sluggish demand for loans and concern for the safe investment of its financial wealth.