

Real Economy Financing Remains Weighed Down by Crisis

Corporate Creditworthiness Indicators Worsen

Austria's Economy Stagnates in the First Quarter of 2010

The Austrian economy had recovered perceptibly in the third quarter of 2009 only to level off in the two following quarters. In the first three months of 2010, seasonally and working-day adjusted GDP growth stagnated quarter on quarter, and exports lost momentum again. In the first quarter of 2010, investment in equipment diminished further, given continued very low production capacity utilization. Construction investment contracted for the second year in a row.

Corporate profits shrank substantially in the wake of the crisis. Mirroring developments throughout the euro area, the gross operating surplus of nonfinancial corporations went down by 9% in 2009, sinking to the nominal level of 2006. This decline not only had a negative impact on the indicators for corporate stability and creditworthiness, but also acted as a drag on companies' internal financing potential.

External Financing Declines

The enterprise sector's external financing decreased even more strongly than its internal financing in 2009. According to financial accounts data, in 2009, companies' external financing volume slipped to one-third of the 2008 level (from EUR 25.2 billion to EUR 8.0 billion).¹ Both equity and debt instruments fell in roughly equal measure, so that the ratio of these instruments in raising capital barely changed: In both

2008 and 2009, the share of equity in total liabilities came to about 38%.

Sharp Slowdown in Lending Momentum

Bank lending accounted for the lion's share of the decline in external financing. Having represented 65% of external financing in the second half of 2008, bank loans extended by Austrian banks made a negative contribution to external financing in 2009. Bank lending growth weakened progressively throughout 2009, with the annual rate of change according to MFI balance sheet statistics (adjusted for reclassifications, changes in valuation and exchange rate effects) finally hitting negative territory at the end of 2009 and coming to -1.7% in March 2010.² Short-term credits were on the decline, whereas lending at longer maturities continued to expand, albeit at a far slower pace.

It is difficult to separate the supply-side factors involved in the decline in lending to enterprises from the demand-side factors. The results of the Eurosystem Bank Lending Survey for Austria indicated that banks had tightened lending standards from the onset of the crisis until mid-2009 and then kept standards constant until the first quarter of 2010. In absolute terms, lending standards thus are at historically very high levels, above all because banks' risk assessment had changed: Since the beginning of the crisis, risk assessment was the major factor governing banks' lending policy. However, at the height of the crisis, refinancing

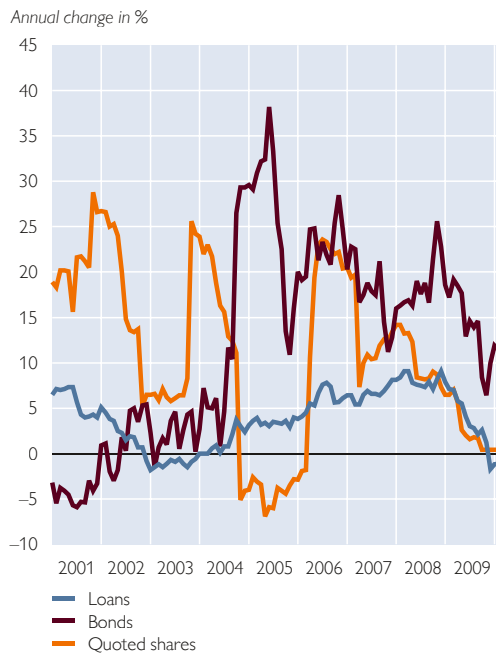
¹ Adjusted for foreign-controlled holdings of special purpose entities (SPEs).

² For the development of bank loans to the corporate sector, see the OeNB's *Kreditbericht* (available in German only at www.oenb.at).

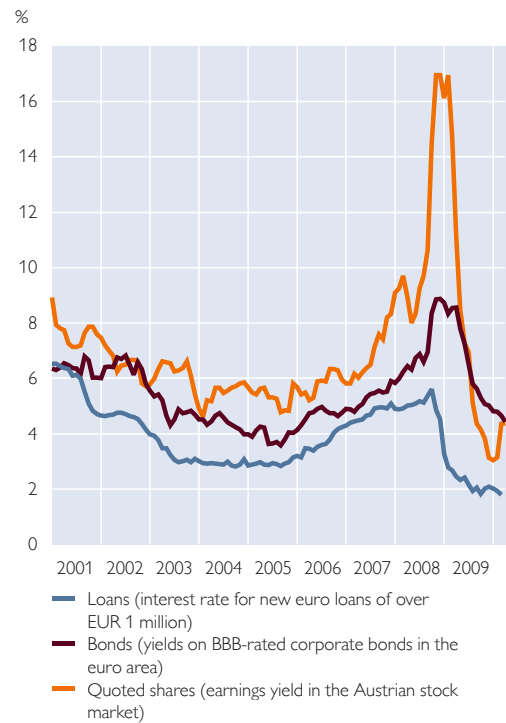
Chart 17

Volumes and Conditions for Key Elements of Corporate Financing

Financing Volumes



Financing Conditions



Source: OeNB, Thomson Reuters, Wiener Börse AG.

issues also played a role in banks' lending policy (see chart 18).

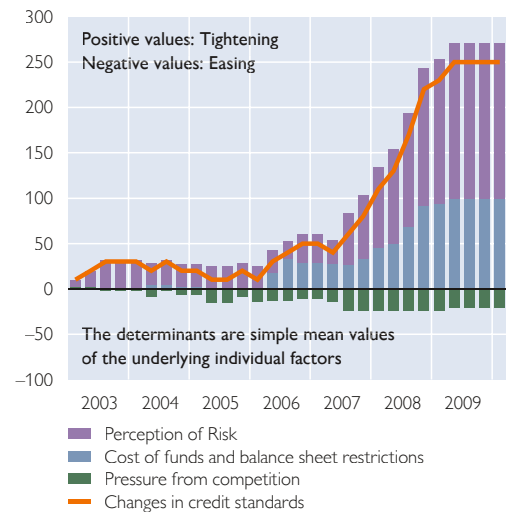
As the crisis wore on and corporate investment contracted, demand-side factors gained importance for the decline in lending. For roughly one-and-a-half years, Bank Lending Survey respondent banks have been reporting that enterprises' credit demand has been attenuating. Larger companies were hit harder than small and medium-sized enterprises both by the drop in demand and by the greater restrictiveness of banks' lending policy.

Overall, several companies were affected by tighter lending conditions, most of all those whose creditworthiness deteriorated in 2008 and 2009. Surveys of Austrian companies confirm this assessment. Since the beginning of 2009, the OeNB has regularly commissioned the Austrian Institute of Eco-

Chart 18

Determinants of Credit Standards for Loans to Enterprises

Cumulative change since Q1 03 (diffusion index and contributions to change)



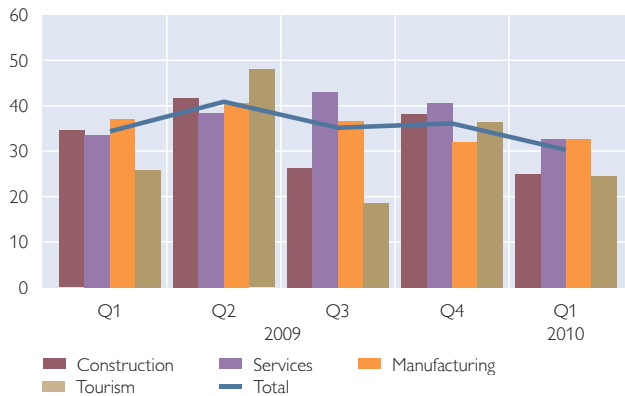
Source: OeNB (Bank Lending Survey).

Chart 19

Net Share of Companies Reporting Tighter Lending Conditions For New Loans

Industries

Shares in %



Number of Employees

Shares in %



Source: WIFO.

conomic Research (WIFO) to perform special surveys about lending terms and conditions. Accordingly, the share of companies faced with tighter credit conditions was higher in all surveys than the share of companies reporting an easing of credit terms, but the former share diminished from 42.9% at/ in mid-2009 to 33.4% in the first quarter of 2010. This slight relaxation of credit terms was noted in all industries and in companies of all sizes, and differences between sectors narrowed in the most recent survey rounds. However, unlike banks' assessment, companies state that credit standards have been tightened further.

The WIFO survey also came to the conclusion that large companies were hit harder by the crisis than small and medium-sized enterprises. Considering that large enterprises – which are commonly more export-oriented – were more severely affected by the international slump in economic activity, this means that the companies that were hit hardest by the crisis were also those

that registered the strongest deterioration of lending conditions.³

The development of financing costs reduced the burden on loan financing. Interest on lending was at historically low levels in the first months of 2010 after the ECB had massively reduced key interest rates. For the short interest rate fixation periods that are typical of corporate lending in Austria, the key interest rate cuts of the years 2008 and 2009 have meanwhile been fully passed on to borrowers. In February 2010, interest rates for new loans of up to EUR 1 million to nonfinancial corporations stood at 2.4%, those for loans of over EUR 1 million were 1.8%, i.e. in both cases more than 3½ percentage points lower than in October 2008.

Further Increase in Bond Financing

Unlike the slowdown in bank lending, the issuance of bonds by Austrian companies showed strong momentum in 2009 and during the first months of 2010. In 2009, the corporate sector covered more than two-thirds of all ex-

³ See Kwopil, C. 2009. *Actual Implications of the Current Economic Crisis for Austrian Enterprises – Results of a Company Survey*. In: *Monetary Policy & the Economy Q4/09*. OeNB. 98–110.

ternal financing needs by issuing bonds. In February 2010, the annual growth rate of corporate bonds was 17.7% according to securities issues statistics. However, for only a small share of Austrian companies, bond issues constituted an alternative for taking out loans, as for the most part, only large companies are able to issue bonds.

The pronounced decline of bond yields, propelled by the normalization of market conditions and the reduction of risk premiums after the crisis had peaked, contributed significantly to the dynamic development of bond issuing activity. Yields on BBB-rated bonds sank from a high of nearly 9% in the last months of 2008 to around 4.4% in April 2010.

Financial Crisis Brings Equity Financing to a Halt

The crisis had virtually dried up financing via the stock exchange and the recovery in stock issuance has been only tentative, even though since fall 2009, some companies have carried out capital increases. There have been no new listings by Austrian nonfinancial corporations since the onset of the crisis. Net new issues (including delistings) in the Austrian stock market ran to EUR 0.3 billion in 2009 and to EUR 55 million in the first three months of 2010. In any event, in the second half of 2009, quoted shares accounted for nearly 7% of the admittedly sharply lower external financing volume after having stood at nearly zero in the first six months of 2009.

Investors apparently consider purchases of Austrian stocks rather unprofitable at the current juncture, given the low earnings yield (inverse of the price-to-earnings ratio). The earnings yield plummeted from highs of roughly 17% in November and December 2008, at the height of the crisis, to

around 3% at the beginning of 2010 and then recovered slightly until April 2010. At times, however, the earnings yield slipped below the yield on ten-year Austrian government bonds.

In 2009, corporations raised approximately 38% of their external financing in the form of equity (including over-the-counter equities), noticeably less than in the preceding years (average for 2004 through 2008: 50%). The proportion of shares and other equity in enterprises' total liabilities remained unchanged at 47.5% in the second half of 2009.

Creditworthiness Indicators Deteriorate

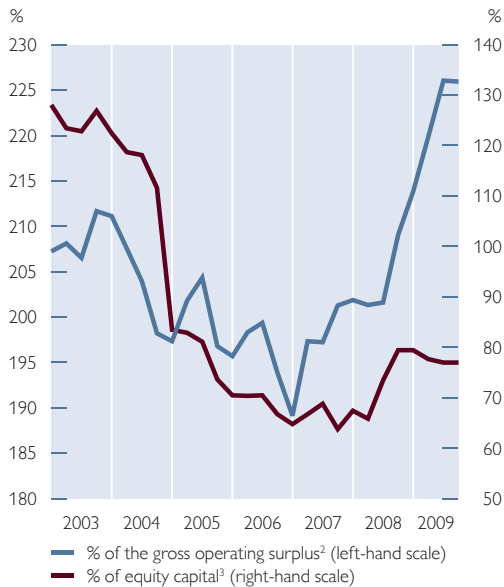
The indicators of companies' creditworthiness worsened in the wake of the crisis. In spite of the smallest increase in the absolute level of corporate debt in four years, the ratio of corporate debt to profits rose significantly in 2009 as a result of the drop in profits. Between the third quarter of 2008 and the third quarter of 2009, debt expanded from 202% to 226% of the gross operating surplus and then remained constant in the fourth quarter of 2009. In fact, by relation to equity, corporate debt even contracted marginally in 2009.

Insolvency statistics mirrored the economic downturn as well, but also indicated stabilization in the first quarter of 2010. Based on moving four-quarter averages to rule out seasonal fluctuations, the number of insolvencies grew far more slowly in the first quarter of 2010 than during 2009, and in terms of the total number of enterprises, the number of insolvencies even declined slightly. Insolvency liabilities also increased at a far slower rate in the first three months of 2010. In relation to the total liabilities of the corporate sector (according to national financial

Chart 20

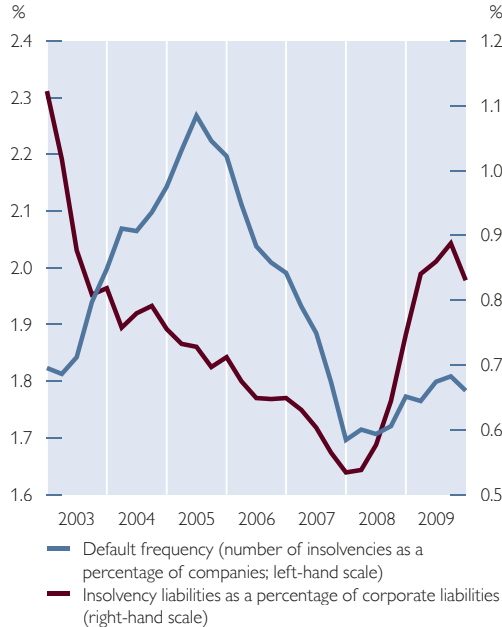
Indicators of Corporate Creditworthiness

Corporate Sector Debt¹



Development of Corporate Insolvencies

Moving four-quarter averages, year on year



Source: OeNB, ECB, Kreditschutzverband von 1870.

¹ Short-term and long-term loans, money market and capital market instruments.

² Including mixed income of the self-employed.

³ Quoted shares and other equity.

accounts), insolvency liabilities measured as the average of the previous four quarters fell from 0.84% in the fourth quarter of 2009 to 0.78% in the first quarter of 2010 after having jumped from 0.49% in the second quarter of 2008.

Conclusion: Only Slight Easing So Far on the Financing Side

The ongoing crisis is still impairing the financing of Austrian companies, although the situation has eased slightly since fall 2009. After the key interest rate cuts in 2008 and 2009, interest rates on loans are historically low. Banks' credit standards are noticeably higher than before the crisis, but this reflects primarily a cyclically linked deteriorated risk assessment of companies by banks. Banks have not tightened their lending policies further since mid-

2009. However, they have to a greater extent been factoring borrowers' risk-bearing capacity and economic prospects into their lending decisions. With creditworthiness indicators having worsened, many companies have found it harder to gain access to funds. The number of companies faced with tighter lending appears to have fallen since autumn 2009, however. There is no evidence that banks have limited their lending more than they usually do during an economic downturn. The risk that a possible economic recovery could be hampered by banks not providing enough funds by way of lending to meet corporate sector financing needs is not to be considered large at this point.

Households Show Low Propensity to Borrow

Disposable Income Diminishes

The household sector's real disposable income sank by 1.1% in 2009 year on year against 2008 (see chart 21), declining for the first time since 1997. Two important influences on this reduction were rising unemployment and decreasing property income. The unemployment rate (Eurostat definition) climbed from 3.8% in 2008 to 4.8% in 2009. Property income was sharply affected in 2009, above all because profit distribution declined markedly and earnings withdrawals fell to zero in most cases. In addition, the cut in interest rates in 2009 reduced investment incomes as a result of lower interest incomes. In light of these difficult conditions and weak credit demand (see the next section of this report), households trimmed their saving ratio from 12% in 2008 to 11% in 2009 so as to maintain their level of consumer spending.

Sluggish Credit Demand

Household borrowing growth has been edging up since November 2009 but still remains far below the level recorded prior to September 2008, when the U.S. investment bank Lehman Brothers collapsed. Whereas the MFIs' lending claims on households had still been augmenting by 3.8% year on year in August 2008, this rate had fallen to only 1.1% in March 2010 (see chart 22, left panel). Consumer loans again made a negative contribution to growth, shrinking by 2.6%, whereas housing and other loans continued to make a small positive contribution. However, the fluctuations were not as pronounced in Austria as in the euro area, where credit growth came to a complete standstill between April and October 2009 following years of high growth. Euro area credit growth revived after that, coming to 2.2% in March 2010 year on year (see chart 22, right panel).

According to the Bank Lending Survey, in the first quarter of 2010, banks' lending standards and household demand for credits remained basically unchanged. Weak credit growth in Austria among other things mirrors households' uncertainty about their income outlook.

Debt Burden Remains Stable

Even though disposable income displayed weakness, households' debt burden remained stable, among other things on account of their low new borrowing and low interest rates. In the fourth quarter of 2009, household debt ran to 88% of net disposable income, thus remaining 2 percentage points below the level recorded prior to the onset of the financial crisis in the second quarter of 2007 (see chart 23, left panel). Interest expenses dropped from 4% of disposable income in the fourth

Chart 21

Household Incomes and Savings



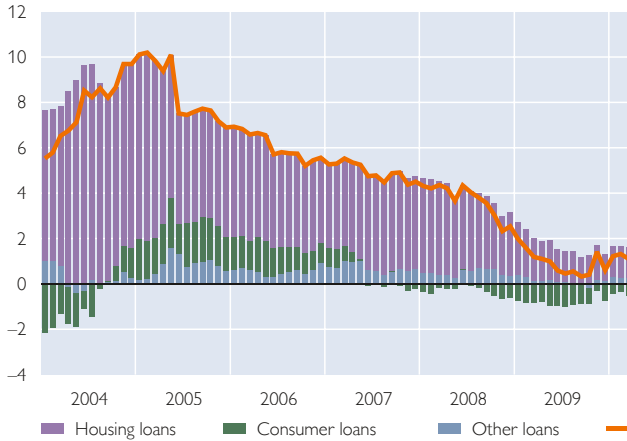
Source: Statistics Austria.

Chart 22

Growth Contributions of MFI Loans to Households

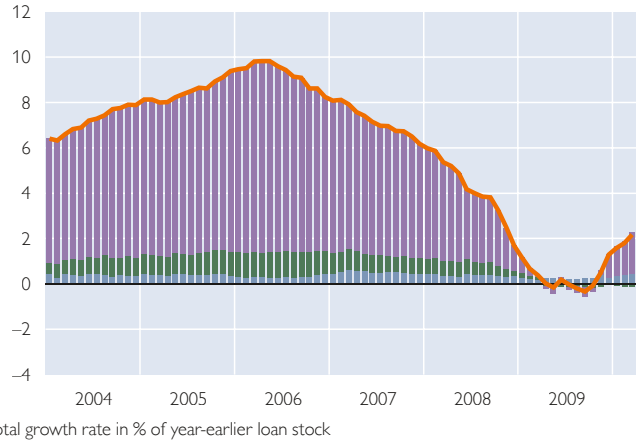
Austria

Percentage points



Euro Area

Percentage points



Source: OeNB.

Note: Change in MFI claims on households adjusted for reclassifications, value adjustments and exchange rate effects.

quarter of 2008 to 2.4% in the first quarter of 2010 on the back of low interest rates.

However, as the right panel of chart 23 shows, the share of variable rate interest in new lending is rising steadily; it accounted for 81% of disposable income in the first quarter of 2010. This

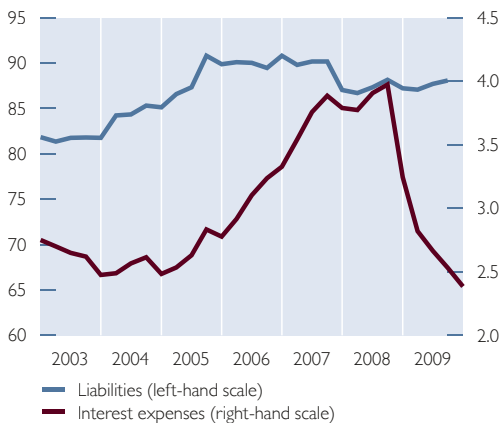
share of variable rate loans is very high in Austria compared to the euro area. While holding such loans helped households slash their interest expenses faster in 2009, because the ECB's interest rate cuts were translated faster into reductions in interest rates on variable rate loans, interest rates on such loans

Chart 23

Debt Indicators

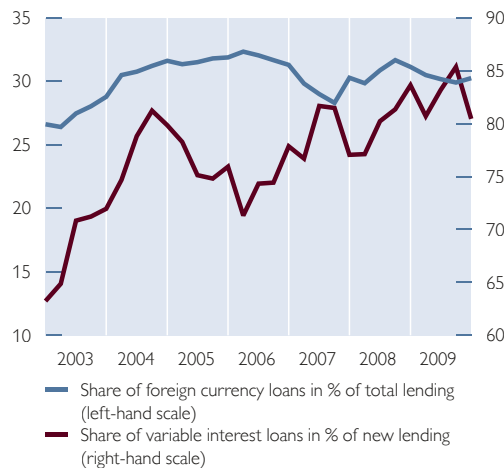
Debt and Interest Expenses

% of net disposable income



Foreign Currency and Variable Interest Loans

%



Source: OeNB.

are likely to rise just as quickly if key interest rates are raised again.

The continued high share of foreign currency lending and the related exchange rate risk and risk associated with repayment vehicles constitutes a risk to households' debt-servicing capacity. While the share of foreign currency lending has diminished somewhat, it is still very high compared to the euro area average. In the first quarter of 2010, foreign currency loans

constituted 30% of the household sector's borrowing.

To fully assess risk, it is necessary to identify financially vulnerable households. Box 1 describes overindebtedness of households on the basis of microdata. The analysis shows that overindebtedness is frequent among low-income household categories, which is evidence that the aggregate data may well underestimate risks.

Box 1

Typical Features of Overindebted Households

Household risk indicators gleaned from macroeconomic data – indicators such as the debt ratio, the interest payments as a percentage of net disposable income, and the share of foreign currency loans – had been high for a long time, but in recent months, these indicators have all remained stable or have declined marginally for various reasons. However, such aggregate indicators reflect the household sector's risks to the financial market only to a limited degree, because they do not provide any information about the distribution of debt among households and about households' debt-servicing capacity. As a case in point, the current economic crisis originated with U.S. households that were severely overindebted and that could no longer service their debt. Therefore, it is important to combine information about aggregate developments with disaggregated data about household overindebtedness.

In 2008, the specific module of the EU Statistics on Income and Living Conditions (EU-SILC) survey explored overindebtedness. Several evaluations of the pertinent data set on overindebted households in Austria are presented below. The analysis here is limited to housing loans for households' principal residence, which accounts for the bulk of household debt. Three different definitions of overindebtedness are used to identify overindebted households:¹ (1) relative overindebtedness – the condition in which households are in arrears on housing loan repayments; (2) subjective overindebtedness – the condition in which debtor households had experienced "serious financial difficulties in the past five years"; and (3) absolute overindebtedness – the condition in which housing debt is higher than households' entire housing wealth and in which households state that they had to limit spending to be able to pay for housing costs. The OeNB's Household Survey on Housing Wealth 2008 (HSHW) provides the last of these definitions, as EU-SILC contains no data on household indebtedness or household wealth.²

The first column of the table below shows how many households have incurred debt solely because they have purchased or maintained their primary residence. These are the only households at risk of overindebtedness. The second and third columns indicate the shares of households that are overindebted according to the first and second definitions of overindebtedness, broken down by various socioeconomic features, such as household income, age of the main earner, education level, household type (family status) and activity status. All evaluations point toward a tendency of the aggregate indicators to underestimate the risks to the financial market. The reason: Vulnerable household categories are overindebted to an above-average degree. Incomes show this fact most clearly: Whereas 11.6% of households in the lowest

¹ Based on Angel, S., M. Einböck, K. Heitzmann and U. Till-Tentschert. 2009. Verschuldung, Überschuldung und finanzielle Ausgrenzung österreichischer Privathaushalte. In: Statistische Nachrichten 12/2009. 1104–1116.

² A comparison of the evaluation using the third definition with those using the first and second definitions is possible only to a limited extent, as the former and the latter are based on different data sets and as the data of the Household Survey on Housing Wealth 2008 refers not to the main earner but to the housing owner or tenant.

Overindebted Households

	% of households with housing loans outstanding (EU-SILC)	% of debtors in arrears in the past 12 months (EU-SILC)	% of debtors with serious financial difficulties in the past 5 years (EU-SILC)	% of debtors with debt exceeding housing assets and a small financial margin (HSHW)	Median of the debt-to-asset ratio (%) (HSHW)
	Schare, %				Median, %
All households	27,3	4,0	10,1	9,5	29,3
Quintile of net income					
1	10,4	11,6	15,7	15,0	27,5
2	18,1	5,8	15,2	12,2	23,1
3	26,5	3,6	12,4	20,8	33,3
4	36,7	3,6	8,2	5,4	27,6
5	45,0	2,2	6,9	2,2	29,2
Age (main earner)					
Up to 19 years of age	24,0	0,0	42,7	0,0	73,6
20 to 39 years of age	32,3	3,8	11,5	13,0	41,3
40 to 64 years of age	34,2	4,1	9,0	6,9	20,8
65 years of age and older	8,8	5,2	9,5	11,0	19,2
Highest education level (main earner)					
Compulsory schooling	23,9	5,2	13,0	15,6	28,6
Intermediate or higher technical/vocational school	29,1	1,9	6,9	11,3	27,6
High school graduation	33,8	4,0	8,1	1,3	28,8
University degree	31,9	0,0	3,1	7,9	33,3
Family status (main earner)					
Unmarried	23,9	4,6	12,3	7,0	27,3
Married	35,1	3,3	7,5	9,7	29,3
Separated or divorced	25,2	6,6	17,0	12,1	35,7
Widowed	8,4	1,9	11,7	11,3	10,4
Activity status (main earner)					
Employed	38,2	3,0	8,9	9,8	31,1
Self-employed	35,2	6,2	14,1	1,9	39,7
Unemployed	11,3	27,8	49,8	34,5	16,8
Nonemployed	12,4	4,9	8,9	10,3	18,4

Source: EU-SILC 2008, OeNB Household Survey on Housing Wealth 2008 (HSHW).

income group (the bottom 20% of households in terms of incomes, i.e. the poorest households in Austria) were in arrears on their loan payments at least once in the past 12 months, this figure shrank to 2.2% of debtors in the highest income group (the top 20% of households in terms of incomes, i.e. the richest debtors). It must be noted, however, that the households in the lower income groups have taken on debt more rarely than those in the top income groups. Furthermore, unemployment plays an important role in overindebtedness: 27.8% of households with unemployed main earners are in arrears; this applies to only 3% of households with employed principal earners. Broken down by household type, the most frequently overindebted group of households is that with separated or divorced main earners (6.6%). These households are headed primarily by single parents. Finally, broken down by education level, an especially large proportion of overindebted households (5.2% each) belongs to the lowest education category – and to the top age group. The pattern of overindebtedness is very similar using the second definition (households' subjective impression of being overindebted).

Data derived from the HSHW on absolute overindebtedness (third definition) and debt-to-wealth ratios are presented in the fourth and fifth columns. Notably, in addition to the

above-described patterns of overindebtedness, these figures reveal that young households (20 to 49 years of age) and middle-income households (third quintile) are more frequently “absolutely overindebted.” It may well be that these households have only serviced a small proportion of their debt relative to their wealth and that they therefore have to limit spending (third definition), but that they still have enough income to service their debt (fully), as they are rarely in arrears or financial difficulty (according to the first and second definitions). In terms of the debt-to-wealth ratios, households with separated or divorced main earners, in particular single-parent households, are most seriously affected: The median household in this category has debt amounting to 35.7% of its wealth. The debt-to-asset ratio is low for unemployed households (16.8%), a sign that although these households display above-average incidences of overindebtedness, debt in most of these households is below average size in proportion to their wealth.

Households Have Begun to Accumulate Wealth Again

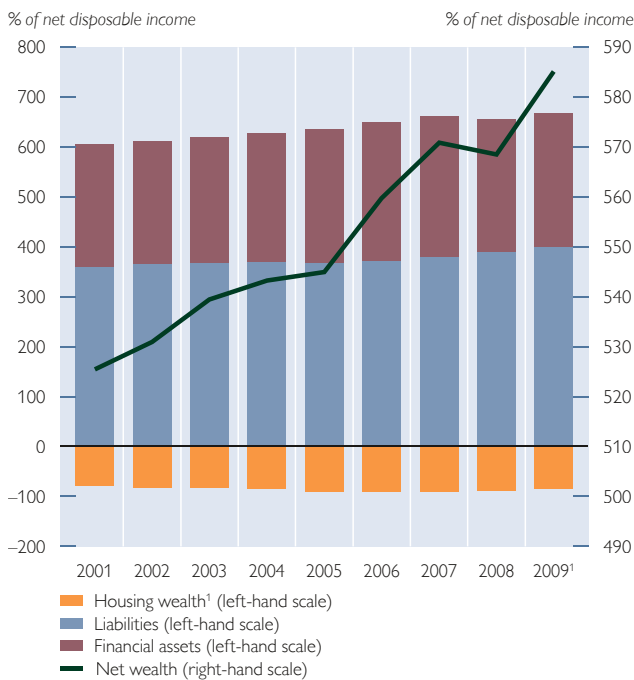
Unfortunately, no data about household total wealth are available for Austria. The financial accounts statistics contain details about financial assets and liabilities but not about housing wealth or

nonfinancial assets. To provide an indicator of the development of total household wealth, analysts estimated property assets on the basis of the capital stock for residential housing in the national accounts and of additional information gleaned from the OeNB’s

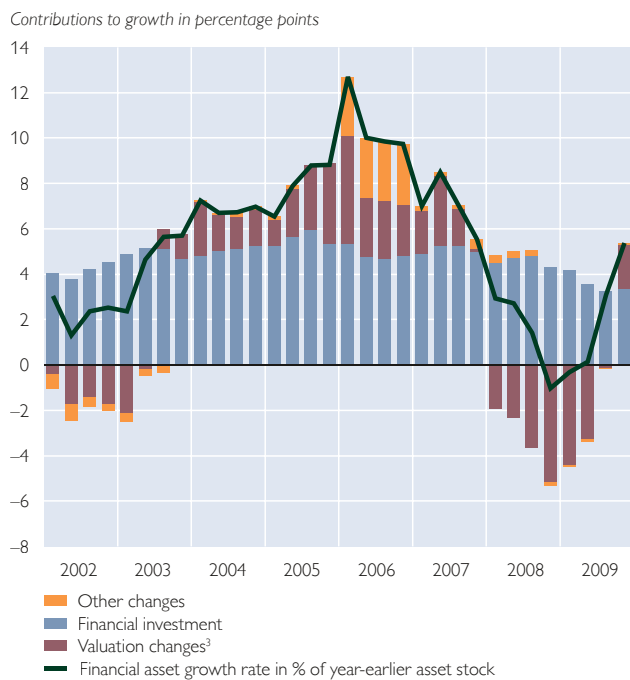
Chart 24

Development of Household Wealth

Household Net Wealth



Changes in Financial Assets



Source: OeNB, Statistics Austria.

¹ Housing wealth consists of residential housing wealth plus estates in land. Residential housing was estimated on the basis of the capital stock for residential housing according to national accounts data. Land assets were added pro rata on the basis of the OeNB’s Household Survey on Housing Wealth 2008.

² 2009 estimated on the basis of the information available.

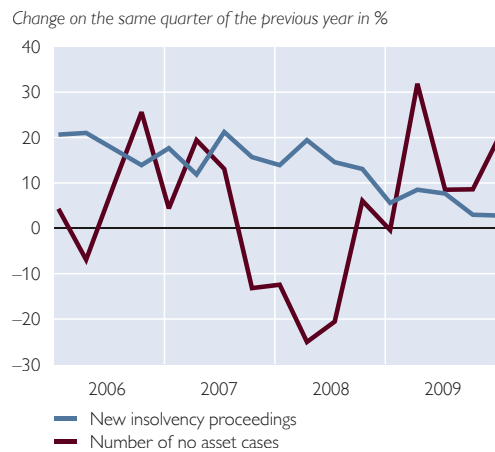
³ Securities calculated on the basis of securities data, other aggregates calculated as the difference between stock changes and transactions.

HSHW 2008.⁴ In combination with the national accounts data, these data allowed for an estimate of net household wealth (excluding nonfinancial assets). The development of household wealth shows that in 2008 household assets deteriorated for the first time since 2001⁵ (see chart 24, left panel). High unrealized valuation losses were the reason for the deterioration (see chart 24, right panel). The losses offset valuation gains of the four preceding years. Household net wealth declined by only 3 percentage points of disposable income, however, in 2008. This was far less than in the euro area as a whole, where the loss represented about 50 percentage points.⁶ The reason for this discrepancy is that the Austrian household sector – unlike the household sectors of some euro area countries, notably Spain or Ireland – continued to amass housing wealth. Preliminary estimates of housing wealth in 2009 suggest a renewed rise in household net wealth driven mainly by the revival of valuation gains in the fourth quarter of 2009. Increases in stock holdings by 56.7% and of mutual fund shares by 10.9%, both against the same quarter of 2008, were primarily responsible for this rise.

Number of No Asset Cases Rises

Households' income-related risks increased further on account of the rise in the number of unemployed persons. The insolvency statistics confirm this at least in part. Whereas the number of new insolvency proceedings grew somewhat more slowly year on year in

Chart 25
Development of Personal Insolvencies



the first quarter of 2010 (+2.8%) than in the preceding quarters (+3.0% in the fourth quarter of 2009), the increase in the number of no asset cases skyrocketed to 20.8% in the first quarter of 2010 from 8.6% in the fourth quarter of 2009. The jump in no asset cases means that a growing number of private debtors do not even have enough assets to settle their insolvencies in court. This may be caused by rising unemployment, as debt settlement on the basis of a payment plan is out of the question without a sufficient income level. Chart 25 shows the development of personal insolvency cases.

Conclusion: Debt Burden Declines despite Higher Income Risks

The low levels of both new household debt and interest rates have eased the debt burden on the household sector in

⁴ Residential housing wealth was estimated on the basis of the capital stock for residential housing according to national accounts data; land assets were added pro rata based on information on the structure of real property wealth in the OeNB's Household Survey on Housing Wealth 2008. Residential housing wealth plus estates in land represent property wealth, referred to as housing wealth in the survey. For more details on Austrian housing wealth, see Fessler, P., P. Mooslechner, M. Schürz and K. Wagner 2009. *Housing Wealth of Austrian Households*. In: *Monetary Policy & the Economy Q2/09*. 104–122.

⁵ No data are available for the period preceding 2001.

⁶ Source: *Financial Stability Review of the ECB of December 2009*.

recent months. Yet income risks have risen further: The worsening of conditions on the labor market has reduced household disposable income. Reduced incomes in turn raise the risk of house-

holds defaulting on bank loans. Moreover, this risk is exacerbated by the fact that vulnerable, low-income households are more likely to be overindebted than other households.