Financing Conditions Have Tightened for the Real Economy Sectors

Corporate Sector Slightly Affected

Output Growth Is Past its Cyclical Peak

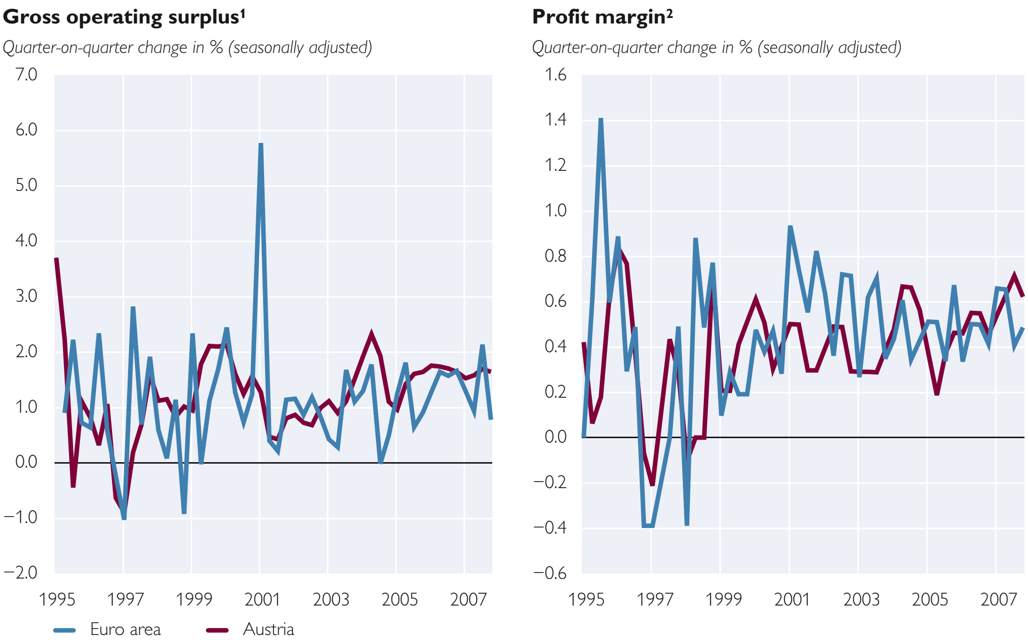
Despite the ongoing turbulence in international financial markets and its negative effects on global economic activity, the Austrian economy performed relatively well in the first half of 2008, even though real GDP growth is expected to be less dynamic in 2008 than in the two previous years. Owing to the euro's increasing external value and the cooling of global economic activity Austrian exports slowed down. In the course of 2007, investment lost momentum – a trend which lasted in early 2008. Real consumer demand, which has clearly lagged behind the development of real disposable household income in recent years, continued to develop moderately.

After having grown robustly in recent years, corporate profitability in Austria – similarly to the euro area as a whole – continued to improve in 2007 despite the appreciation of the euro and high crude oil prices, as the development of the profit margin[1] and gross operating surplus[2] indicates.

The economic boom of the past two years is also reflected in the develop-

Chart 3

Indicators of Profitability Performance in the Corporate Sector



Source: Eurostat.

1 Inkluding mixed income of the self-employed.
2 GDP deflator less unit labor costs.

1 *The profit margin is the ratio of the gross value added deflator to unit labor costs.*

2 *The gross operating surplus is the surplus created by corporate operations after the remuneration of the production factor labor. It is calculated from GDP less compensation of employees and less taxes on production (excluding subsidies) and is thus the SNA (System of National Accounts) equivalent of gross operating income.*

ment of corporate insolvencies – typically a lagging indicator – which in the first quarter of 2008 was 15% below the corresponding 2007 value. Particularly the number of no asset cases fell by approximately 25%, while the decline of newly opened insolvency proceedings came to 4% and was thus significantly weaker. The estimated default liabilities decreased by around 20%. In the first quarter of 2008, the default liabilities sank to 0.5% of the corporate sector's total liabilities (according to the national accounts).

Financial Turmoil Affected the Financing Through Equity Markets

Regarding external finance, turbulence in international financial markets made it more difficult for businesses to raise capital notably in equity markets. According to the securities issues statistics, new issues on the Vienna stock exchange (Wiener Börse AG) by nonfinancial corporations came to EUR 2.2 billion in the second half of 2007, which corresponded to only about one-third of the value registered in the first half of the year. In the first quarter of 2008, no new listings were reported and three issues already fixed were cancelled owing to the unfavorable market conditions. A closer look at the financing raised on the Vienna stock exchange, where international institutional investors are becoming ever more dominant, clearly reveals the tighter integration of corporate financing into international capital flows. Whereas in 2003 the share of foreign market participants in the trading volume at the Vienna stock exchange was less than one-fourth, this figure burgeoned to 64% in 2007.

As stock prices lost ground at the Vienna stock exchange following financial market turmoil, the market capitalization of the nonfinancial corporations listed at the Vienna stock exchange fell by more than EUR 4 billion to EUR 93 billion in the second half of 2007, which corresponded to some 34% of GDP. The market capitalization of all stocks listed on the Vienna stock exchange (including financial corporations) came to almost 56% of GDP at the end of 2007.

Including OTC equities, close to 40% of nonfinancial corporations' external financing volume was in the form of equity in the second half of 2007. As a result of the declining stock prices, the share of equity in total liabilities decreased by almost 1 percentage point to 37.0% in 2007, as equity listed on the stock exchange is valued at current market prices in line with the national accounts conventions.

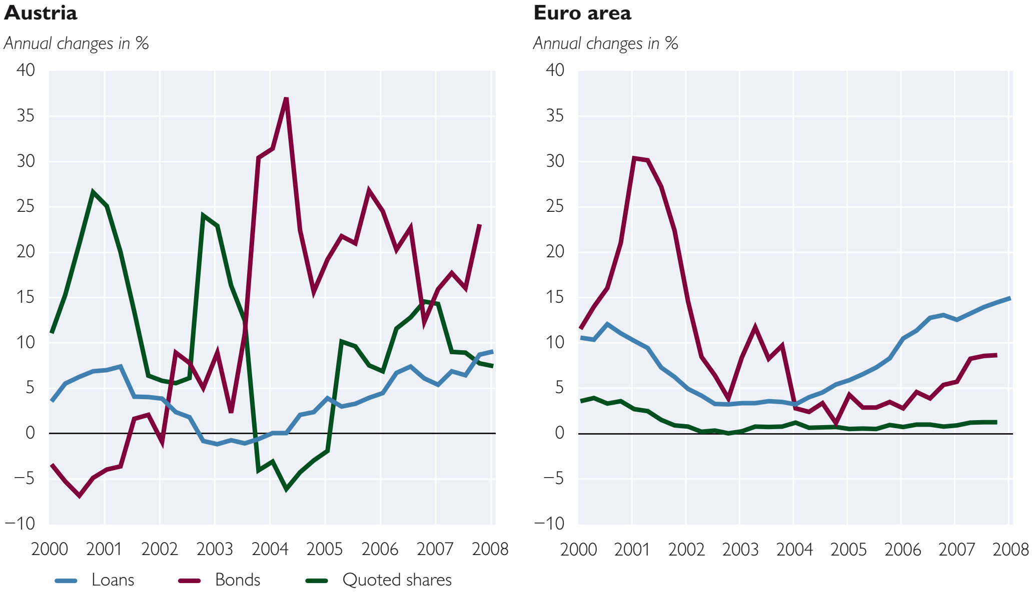
In contrast, the development of bank lending to the corporate sector has not shown any signs of deceleration recently as the annual growth rate of bank loans accelerated in the course of 2007 and came to 9.1% in March 2008.[3] Yet, loan growth still developed less dynamically in Austria than in the euro area. At recently more than 98%, the share of variable rate loans in new business remained very high. In the second half of 2007 and the first quarter of 2008, the maturity structure shifted toward longer-term loans. This is an indication that loans were mainly used to finance investment projects rather than to bridge liquidity gaps.

As companies had difficulties to raise capital on equity markets, they in-

[3] *According to MFI balance sheet statistics. By analogy to the method employed by the ECB, the outstanding volume of bank lending is calculated as the percentage change against the previous year on the basis of changes in transactions, i.e. adjusted for reclassifications, revaluations, exchange rate and other nontransaction changes.*

Chart 4

Key Elements of External Corporate Finance



Source: OeNB.

creasingly turned to banks for loans. At the same time, their good performance improved the creditworthiness of many businesses. According to the Austrian results of the Eurosystem bank lending survey, in the second half of 2007, corporate demand for loans was mainly driven by the need to finance fixed investment. Another key motive for borrowing included the funding of mergers and acquisitions as well as corporate restructuring. In the first quarter of 2008, however, corporate credit demand was no longer driven by any of these factors. The surveyed banks indicated that sound internal financing continued to act as a certain damper on credit demand.

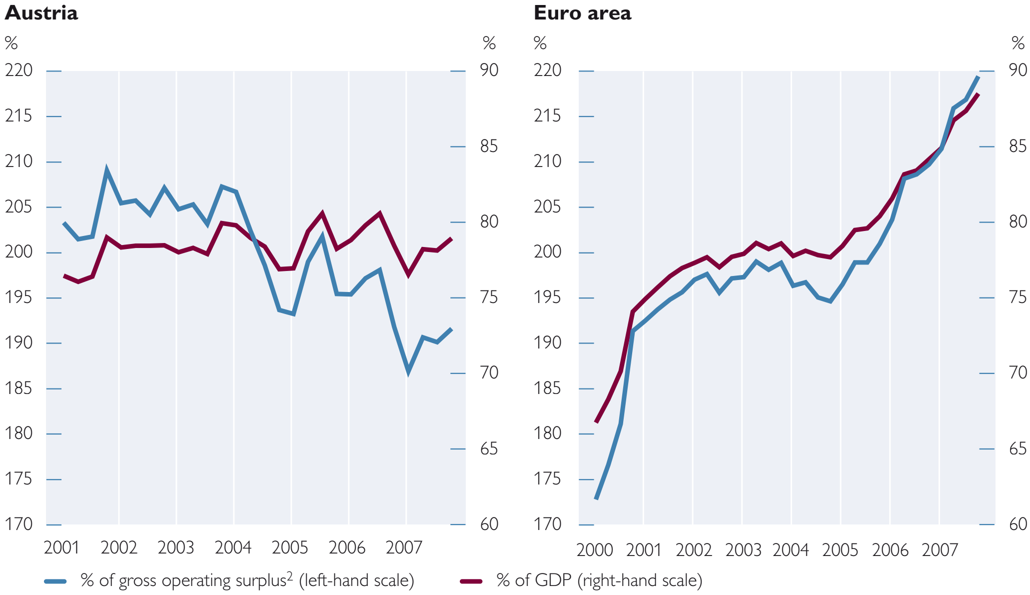
Bond financing remained highly dynamic in the second half of 2007. According to the securities issues statistics, the net issuance of corporate bonds increased by 23.1% compared with the corresponding value of the previous year.[4] Hence, the Austrian growth rate has remained well above the euro area as a whole until recently. In the second half of 2007, construction and real estate companies were the biggest issuers. Close to 70% of the volume issued in this period were fixed rate bonds, while variable rate bonds accounted for the rest. More than 90% of the bonds were denominated in euro and the remainder in Swiss francs.

In 2007, the debt burden of businesses rose slightly faster than their gross operating surpluses (including mixed income of the self-employed) as a result of the rather lively expansion of debt financing. Yet, this increase was more moderate than in the euro area, where the corporate debt ratio has clearly been on the rise since 2005.

[4] *Also based on the ECB method.*

Chart 5

Corporate Sector Debt[1]



Source: OeNB.

[1] *Short-term and long-term loans, money market instruments and capital market securities.*
[2] *Including mixed income of the self-employed.*

Financial Turmoil Tightens Financing Conditions

The financing conditions for Austrian companies were tightened in 2007 and 2008, both for borrowing funds and for issuing equity capital.

Since November 2007, share prices at the Vienna stock exchange declined significantly in the wake of international financial market turbulence. Between the end of October 2007 and the end of March 2008, the Austrian Traded Index (ATX) fell by around 17%. By contrast, the profits of companies listed on the Vienna stock exchange continued their upward trend. As a result, the earnings yield[5] rose visibly since mid-2007, which implies that the cost of tapping the stock market increased. The earnings yield also rose significantly in relation to the development of government bond yields, which is among others an indicator of an increased stock market risk premium.

On the euro bond market, the yields for corporate bonds rose significantly in the 12 months until the end of the first quarter of 2008.[6] Whereas long-term yields on government bonds dropped by approximately ½ percentage point since mid-2007, risk premia on corporate bonds climbed relative to government bonds of similar maturities as credit risks were reassessed following the subprime crisis.

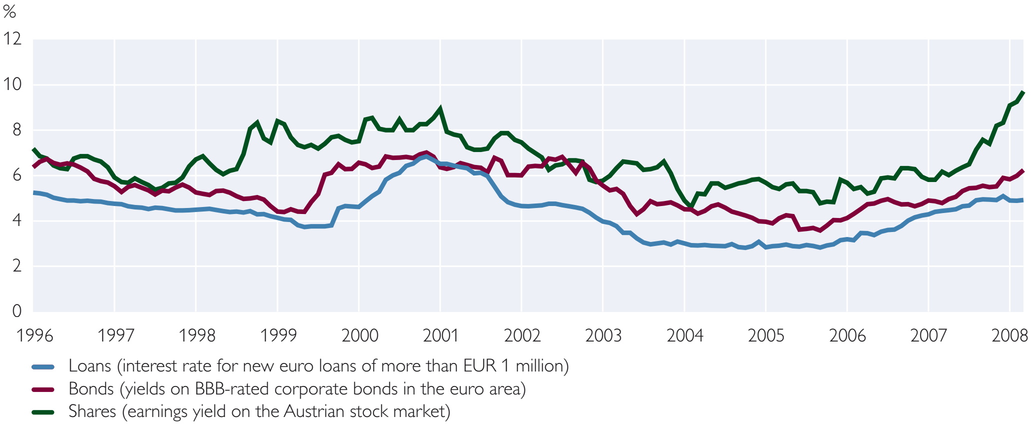
Terms and conditions for new loans have worsened as well. Since the end of 2005, interest rates on corporate loans were going up which, until mid-2007, basically mirrored the ECB's key interest rate increases. From summer 2007 onward and following the crisis of con-

[5] *The earnings yield is the inverse of the price/earnings ratio.*

[6] *Based on the development of BBB-rated bonds in the euro area. No separate data series are available for Austria.*

Chart 6

Corporate Financing Conditions

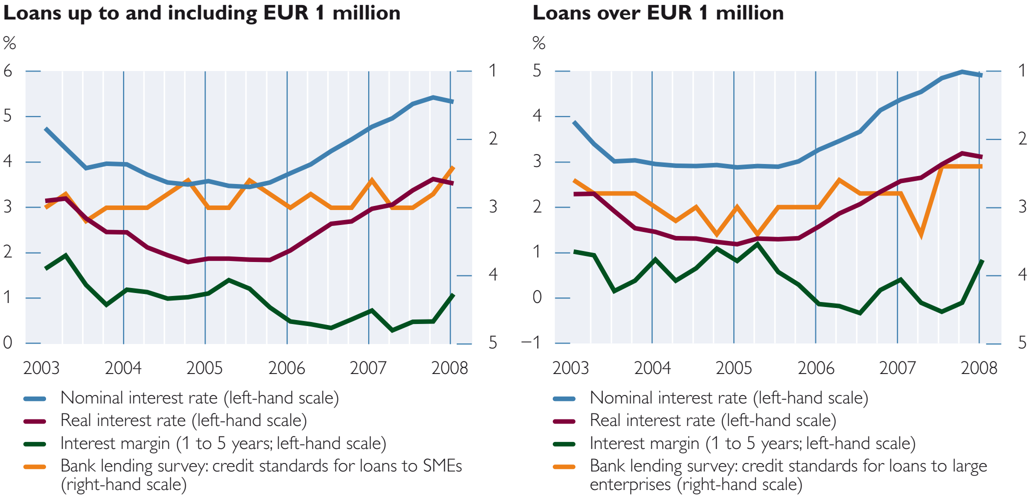


Source: OeNB, Thomson Financial, Wiener Börse AG.

fidence in international financial markets, the increases were caused by a substantial widening of the gap between money market rates – which are the benchmark for variable loan rates – and key interest rates. Risk premia for corporate loans, in contrast, did not start to widen slightly until the first quarter of 2008, as is evidenced by the development of the difference between corporate loan interest rates and swap rates with corresponding maturities (as an indicator of interest rates for largely risk-free assets). In this context, risk premia rose more strongly for large loan volumes than for loans up to and including EUR 1 million.

Chart 7

Conditions for Corporate Loans

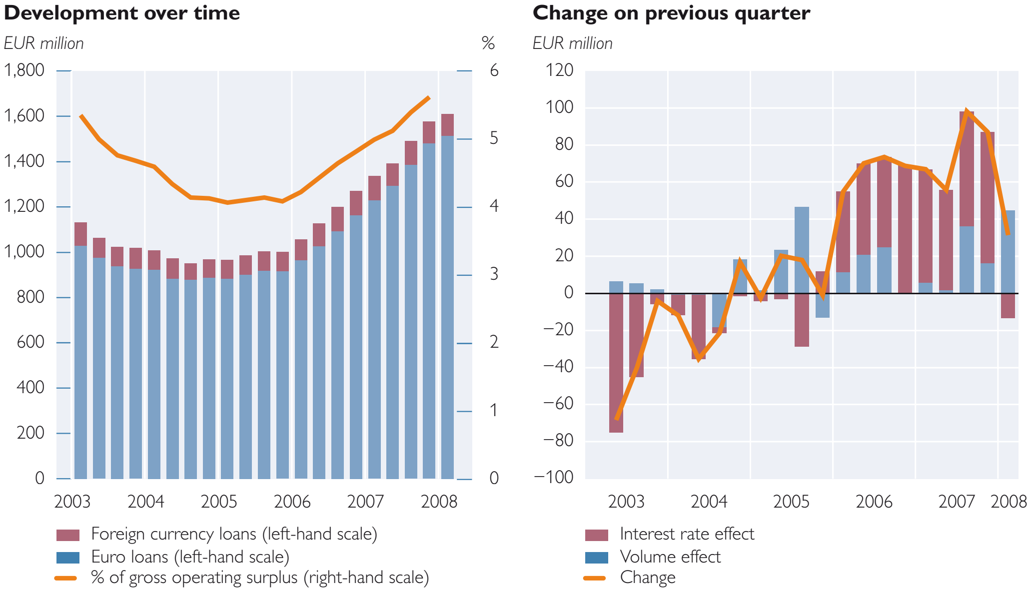


Source: OeNB, ECB.

Note: Right-hand scale ranging from 1 (tightened considerably) to 5 (eased considerably).
Real interest rate: nominal interest rate less the OeNB's HICP forecast for the year following the forecast date.
Interest margin: interest charged for loans with a maturity from 1 to 5 years less 3-year swap rate.
Bank lending survey credit standards: changes in the credit standards for loans to enterprises over the last three months.

Chart 8

Interest Expense on Corporate Loans



Source: OeNB, Eurostat.

Note: Interest expense on euro loans: loans to nonfinancial corporations according to MFI balance sheet statistics multiplied by the corresponding interest rates on outstanding amounts according to MFI interest rate statistics. Interest expense on foreign currency loans: loans to nonfinancial corporations according to MFI balance sheet statistics multiplied by the corresponding interest rates on U.S. dollar, Japanese yen and Swiss franc loans to households and nonfinancial corporations according to MFI interest rate statistics..

This evidence is broadly in line with the Austrian results of the Eurosystem bank lending survey. Since the third quarter of 2007, banks have tightened their margins on loans to enterprises, above all for riskier loans and less strongly for average loans. At the same time, the credit standards for loans to enterprises (to larger corporations and small and medium-sized enterprises (SMEs) alike) have been tightened somewhat since mid-2007. In this respect, the standards for long-term loans were tightened a lot more strongly than those for short-term loans. The changed credit standards are largely attributable to recent international financial market turmoil and its effects on the financing conditions in the money and bond markets.

Slightly Higher Exposure to Interest Rate Risks

Following a decline in recent years, corporate exposure to interest rate risks increased somewhat as credit growth picked up in the second half of 2007. This increase resulted primarily from a rise in liabilities with short-term interest rate risks (loans and variable-rate bonds). In comparison, the share of fixed-income bonds, which are subject to long-term interest rate risks, remained relatively stable in the past few quarters.

Due to the higher share of loans in liabilities and the rise in interest rates, interest expense on corporate loans continued to climb in the first quarter of 2008 (see chart 8).[7] Yet, the interest expense figure shown here includes

[7] *The interest rates for new business (both corporate and household) were used to determine interest on foreign currency loans, as the interest rate statistics do not contain any data on outstanding amounts of foreign currency loans. As the lion's share of foreign currency loans is at variable rates, which are adjusted periodically, this approximation should be fairly adequate.*

only interest payments proper; it does not reflect noninterest rate charges. As is evident from the chart, the rise in interest rate expense in recent quarters can basically be attributed to the higher interest rate level, which did not start to ease somewhat until the first quarter of 2008. Given the high share of variable-rate loans, rising money market rates have very quickly pushed up interest rate expense.

Visibly Reduced Exchange Rate Risks

The corporate sector's exposure to foreign exchange risks shrank markedly in 2007. On balance, enterprises continued to reduce their foreign currency loans, which brought down the foreign currency share in corporate loans from 10.8% at the end of 2006 to just 8.1% at the end of 2007. Moreover, the share of foreign currency-denominated corporate bonds also continued to fall. By end-2007, foreign currency-denominated liabilities accounted for merely 3.5% of overall corporate sector's liabilities against 4.6% a year earlier.

Conclusion: Corporate Financial Position Only Slightly Affected

On balance, the corporate sector's risk position remained favorable in the first quarter of 2008. Even more than half a year after the financial turmoil had begun, the currently available figures do not generally point toward a reduction of the loan supply. In recent quarters lending has, however, become more differentiated in terms of underlying risks. Banks have become more cautious in their financing activities, particularly with regard to large volumes involving high risks. Consequently, competition for prime borrowers might intensify and thus prolong the favorable financing conditions in this sector.

So far, the recent financial turmoil has, first and foremost, driven up financing costs, for equity and debt financing alike. Businesses have seen their debt burden rise quickly, given their high share of variable-rate loans. Although this development does not yet seem to be grave at the aggregate level, highly indebted businesses are likely to have been hit considerably more strongly by the higher interest rates. On balance, businesses' debt/income ratio rose only slightly in 2007. Furthermore, as profits have risen until recently, they enhanced the debt-servicing capacity of companies. Yet, higher financing costs might dampen businesses' propensity to invest. At the same time, continued healthy profitability should enable businesses to substitute internal financing for external financing. Moreover, quite a substantial amount of corporate loans taken out in recent years have probably been used to fund financial transactions, such as mergers and acquisitions. Consequently, a potentially decreasing propensity to lend might affect such transactions and, to a lesser extent, projects in the real economy.

Economic conditions are unlikely to underpin corporate risk positions to the same extent as in the past. With the Austrian economy having visibly lost momentum in 2008, the profit outlook for businesses has become less bright. Last but not least, the high exchange rate of the euro and higher commodity prices may be an additional cost burden on companies.

Financial Market Turbulences Impact on Households' Risk Exposure

Strong Employment Growth, but Stagnating Real Wages

The economic boom years of 2006 and 2007 brought a significant improvement in Austrian labor market conditions. The sharp increase of payrolls by 126,000 over both these years pushed down the Eurostat unemployment rate from 5.2% in 2005 to 4.4% in 2007.

But with a real growth of 1.5%, consumer spending was subdued in 2007, despite the robust income development. This may reflect stagnating real wages and a change in saving behavior prompted by the pension reforms. In a complementary development, the saving rate rose from 9.7% in 2006 to 11.3% in 2007.

Portfolio Shifts in Response to Financial Market Turbulences

Falling stock market prices depressed household demand for stocks and mutual fund shares. Mutual fund shares even registered net capital outflows. As in the first half of 2007, the share of deposits and bonds in financial investment in the second half was high against previous years.

Slight Decline in Exposure to Price Risks

The shift that has been observed over the past few years in the exposure to valuation risks stemming from interest rate changes to valuation risks stemming from price changes did not continue into the second half of 2007. At end-2007, 21% of households' financial assets were subject to valuation risks stemming from interest rate changes and 10% to valuation risks stemming from stock price changes.[8] The low level of new investment, coupled with a fall in prices, caused a slight reduction in households' exposure to price risks in the second half of 2007 relative to end-2006.

High Revaluation Losses in Financial Assets

Household investment in long-term securities, notably stocks and mutual fund shares, suffered above-average revaluation losses in the second half of 2007. Securities accounted for approximately 28% of households' financial assets at end-2007. In the second half of that year, households lost around 5% of the capital invested in these instruments. The revaluation losses on quoted stocks – against private households' stock holdings in mid-2007 – ran to around 16%. While quoted stocks make up some 7% of households' financial assets, around 85% of the revaluation losses can be traced back to price falls in these financial instruments. The financial market developments also hit the performance of mutual funds, which explains why mutual fund shares likewise posted revaluation losses.

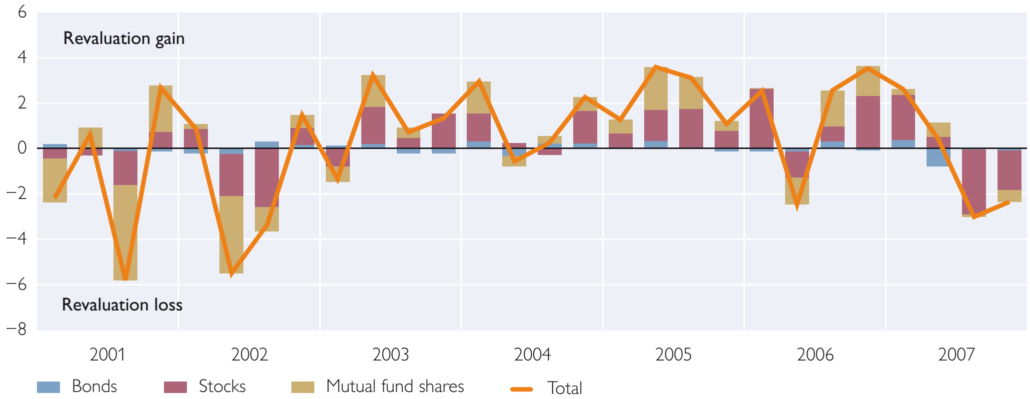
As only a minority of households directly hold investment-related products that are subject to price risk, and since those that do are generally high earners with above-average financial assets, the corresponding risk tends to be low. However, given the increasing popularity of stock-based personal pension plans, more sections of the population are likely to be exposed to stock market risks in future.

[8] *This includes both direct investment in bonds or stocks and indirect investment in the form of fixed income or equity funds as well as the volume of bonds and stocks held through pension funds, severance funds and insurance plans.*

Chart 9

Revaluation Gains and Losses in Households' Financial Assets

% of assets invested in long-term securities



Source: OeNB.

Box 1

Stock Holdings in Austria[1]

Stocks are not widely spread in Austria and stock holdings are concentrated among wealthy, high-income households. This finding from the OeNB's Survey on Financial Household Wealth (SFHW) ties in with available international data. So the households that bear the brunt of sharp price falls in the international financial markets are those that are better able to absorb the losses. Stock price declines thus have little impact on financial stability.

Some 22% of Austrian households hold shares or mutual fund shares. Whereas only 4% of households in the lowest wealth quartile hold shares or mutual fund shares, some 74% of the top 5% on the wealth distribution scale do so.

International comparison shows that Austria not only has a low rate of stock market participation, but that even where households do participate, shares or mutual fund shares make up no more than a small proportion of their total financial assets.

While the percentage of households holding shares or mutual fund shares in Austria is around 22%, it is approximately 34% in the Netherlands and as high as around 49% in the U.S.A. At around 19% in both countries, the participation rates in Italy and Germany are similar to the Austrian rate. At an average of 23% the share of total financial assets held among owners of shares or mutual fund shares in Austria is also relatively low and barely increases even in higher wealth deciles. Differences across countries are primarily attributable to different pension systems (funded versus pay-as-you-go). It is interesting to note that the lowest wealth deciles in most countries share similarly low participation rates. A clear divergence only becomes visible in the upper quartiles, owing in part to institutional reasons (savings subsidies, retirement provisions) and different financial systems (market-based versus bank-based).

[1] *See Fessler, P. and M. Schürz (2008). Stock Holdings in Austria. In: Monetary Policy & the Economy Q2/08. OeNB.*

Interest Income Expands

Looking at the impact of interest rate changes on income from deposits and bonds, we can distinguish between short-term interest rate risk (related to deposits and bonds with an initial fixation rate of up to one year) and long-term interest rate risk.

At end-2007, around 43% of households' financial assets were exposed to short-term and 27% to long-term interest rate risk. The importance of interest rate risk for households' investment ensues from the share of deposits in financial assets (45%), which had already been large before expanding further in the second half of 2007.

Savings deposits (holdings) carried an interest rate of 2.3% in January 2008, and were thus 0.7 percentage points higher than in January 2007. Households' interest income in the second half of 2007 was 19% higher than in the first half-year. Some 65% of the rise in interest income resulted from the climb in interest rates and around 35% from the increase in deposit holdings.

Increase in Austrian Real Estate Prices in 2007 Still Slight by International Comparison

Real estate is of key importance as an asset and as collateral for loans. Price developments in the real estate markets have a strong impact on household debt and consumer and investment decisions through wealth effects. Real estate prices in Austria, which are no more than moderate in comparison to other countries, picked up in 2007. The price increase abated again at the beginning of 2008 and amounted to 1.2% (following 5.1% in the third quarter of 2007 and 3.5% in the fourth, both year on year). The rise in prices for new owner-occupied housing was less steep than that in prices for rented accommodation.

Credit Standards for Home Loans Remain Unchanged while Lending Rates Go Up

According to the Eurosystem bank lending survey, banks – in contrast to the trend observed in the U.S.A. – generally left their credit standards for home loans to households unchanged throughout 2007 and the first half of 2008. However, owing to the short-term scarcity of money market liquidity, increases in interbank interest rates in the fourth quarter of 2007 sharply pushed up interest rates on newly approved loans, particularly those on home loans which reached 5.27% (up 23 percentage points on September 2007, or a rise of almost one percentage point on the 4.28% rate recorded in December 2006). This interest rate was even higher than the euro area average and, for the first time since the start of interest rate statistics (in January 2003) exceeded the traditionally higher average interest rate of 5.22% on home loans in Germany. The same development could be observed in interest rates on aggregate outstanding loans. The interest rates on new consumer loans were 64 basis points higher than a year earlier.

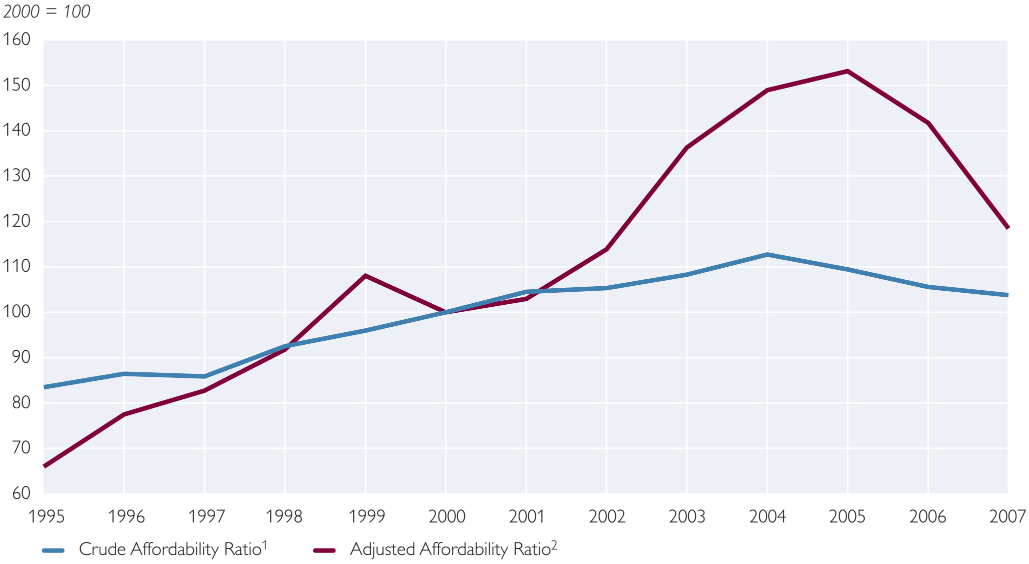
The unadjusted Affordability Ratio[9] has declined slightly since 2005. The rise in the adjusted Affordability Ratio,[10] which takes interest rate effects into account, reflects the increase in interest rates on home loans since 2005 and the consequently higher interest burden on private households.

[9] *For this ratio, households' disposable income, which is a major factor influencing the demand for real estate, is related to the real estate price index.*

[10] *Ratio of disposable household income to the expenses for home loans.*

Chart 10

Affordability Ratio in Austria



Source: OeNB, Statistics Austria, Vienna University of Technology.

[1] *Ratio of disposable income per household to the real estate price index.*
[2] *Ratio of disposable income per household to expenses for home loans.*

Domestic real estate prices can be expected to rise further over the next few years owing to the increasing costs of building materials triggered by high oil prices. However, neither the developments in recent years nor the latest developments in the Austrian real estate market, where price increases largely stem from higher commodities prices, in any way indicate the formation of a price bubble.

Little New Borrowing

The annual growth rate of bank loans, adjusted for non-transaction-related changes, amounted to 5% in 2007. In the second half of that year, the fall-off in credit growth seen since the start of 2005 continued, probably because of the rise in lending rates and weak consumer demand. Credit growth in Austria was around one percentage point below the euro area average. Lately, however, the slowdown in credit growth in the euro area has been much sharper than in Austria; besides higher interest rates, this probably reflected developments in real estate markets in some euro area countries.

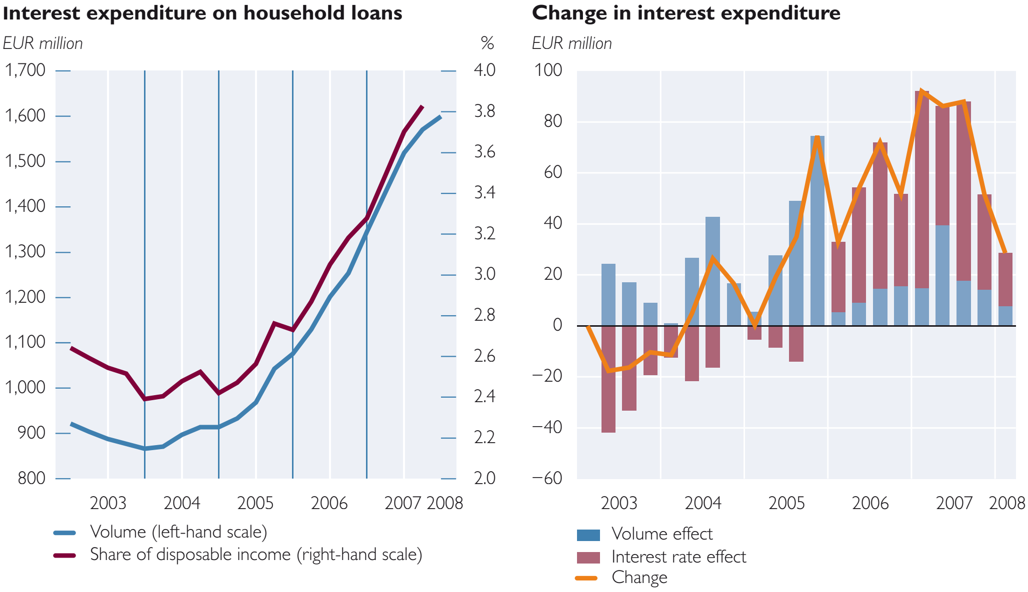
According to the financial accounts, home loans accounted for 62% of credit to households at end 2007. These loans are generally secured by real estate. As explained above, revaluation losses on real estate in Austria and any ensuing problems in securing home loans are likely to be comparatively limited.

At end-2007, loans made up around 35% of households' financial assets or 89% of disposable household income. The ratio of debt to financial assets has been quite stable over the past few years; but household debt relative to disposable income has been climbing steadily.

These aggregated figures, however, do not allow for drawing more qualified conclusions on households' debt burden and debt-servicing capacity. Any further analysis of debt alongside income and wealth at the household

Chart 11

Interest Expense on Household Loans



Source: OeNB.

level would require microdata. A recent analysis[11] concluded that the rising levels of household debt did not necessarily pose a heightened risk to financial stability, since higher-debt households generally own more financial assets.

Interest Expense again on the Rise

The share of variable rate loans to households is relatively high in Austria in comparison to the euro area average. In 2007, around 89% of new consumer loans and over 65% of new home loans were issued at variable rates. And since foreign currency loans are generally at variable rates, too, changes in market rates pass through to consumer interest retail rates relatively quickly.

On the back of rising interest rates and higher indebtedness, the increase in interest expense[12] on household loans seen since the beginning of 2004 continued up to the first quarter of 2008. In the fourth quarter of 2007 the interest expense on retail loans came to 3.8% of disposable household income[13] and was thus 0.7 percentage points higher than in the fourth quarter of 2006. Around three-quarters of the increase in interest expense can be attributed to the higher lending rates. Based

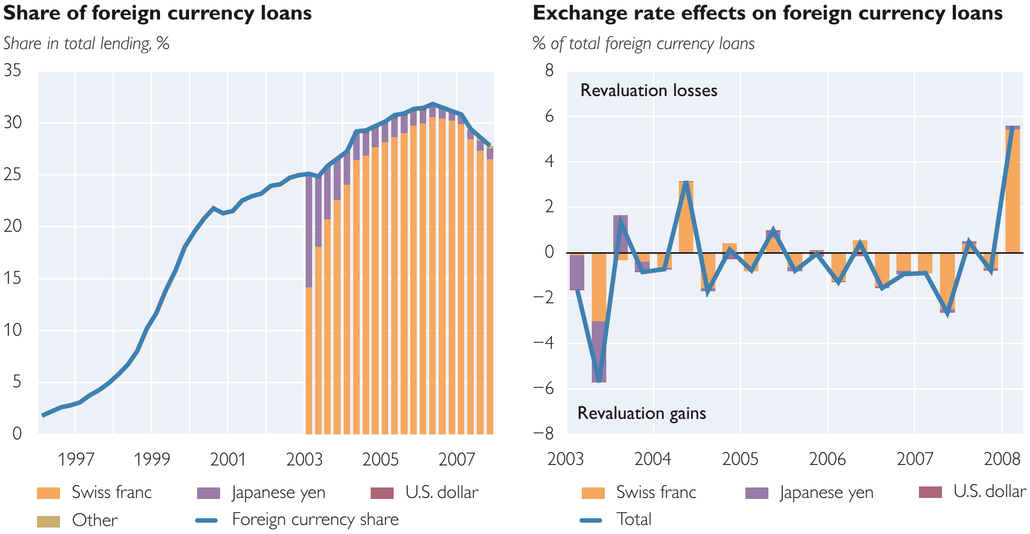
[11] *See Fessler, P. and P. Mooslechner. 2008. Arme Schuldner – Reiche Schuldner? Haushaltsverschuldung und Geldvermögen privater Haushalte auf Basis von Mikrodaten. In: Intervention. European Journal of Economics and Economic Policies, 5(1), 31–45, forthcoming.*

[12] *Interest expense on loans to households is calculated as the product of total loans by purpose, maturities and the respective interest rates.*

[13] *In interpreting these data, it should be borne in mind that the interest expense is calculated in relation to the income of the total population, including those households that have not taken out any loans. Estimates put the share of households servicing loans at around 40% (Fessler, P. and P. Mooslechner, 2008; see footnote 5 Arme Schuldner – Reiche Schuldner? Haushaltsverschuldung und Geldvermögen privater Haushalte auf Basis von Mikrodaten. In: Intervention, European Journal of Economics and Economic Policies, 5(1), 31–45. Forthcoming.). As households with outstanding loans tend to have above-average incomes, the average share of interest expense in their disposable income can be expected to come to about 8%.*

Chart 12

Exchange Rate Risk – Liabilities



Source: OeNB.

on interest expense at end-2007, a 100 basis point rise in lending rates would drive up the share of disposable income spent on interest expense by 0.7 percentage points.

Deposits outpaced liabilities in 2007 and the deposit rates on new business climbed more quickly than lending rates. The ratio of interest expense to interest income consequently fell back by around 20%. All in all, the household sector has thus benefited from the rise in interest rates.

Small Decline in Foreign Currency Loans

The share of foreign currency loans in total lending declined in 2007, coming to 28% at year-end, more than 3 percentage points lower than at end-2006. More than 95% of foreign currency loans were denominated in Swiss francs. The decline in foreign currency loans probably reflects the smaller interest rate advantage of loans denominated in Swiss francs vis-à-vis loans denominated in euro and heightened risk awareness among households.

Despite this decline, the share of foreign currency loans in loans to households was just as high as before, presenting a material exchange rate risk. Owing to exchange rate developments, in the second half of 2007 households still noted slight revaluation gains of around 0.3% of total outstanding foreign currency loans. In the first quarter of 2008, the Swiss franc gained rather strongly against the euro, creating revaluation losses in the order of 5.6% of total lending, which thus surpassed total revaluation gains in 2007. These gains and losses were book gains and losses, however.

According to the OeNB's foreign currency loans statistics, no more than 15% of foreign currency loans in 2007 were instalment loans, 11% were bullet loans not linked to repayment vehicles and 75% were bullet loans linked to repayment vehicles. Owing to the high proportion of bullet loans, foreign currency loans are not only subject to exchange rate risks but also to valuation risks associated with the repayment vehicles, whose performance is impaired by falling stock market prices. Since a large share of foreign currency loans have a residual maturity of more than 10 years, households' capacity to service loans will largely depend on financial market developments over the coming years.

Conclusion: Households' Risk Position Worsened

As a result of financial market developments, households' risk position deteriorated over the second half of 2007. On the asset side the price falls in the stock market led to revaluation losses on households' financial assets. Furthermore, they impaired the performance of stock-based saving instruments and repayment vehicles used to redeem bullet loans.

On the liabilities side, the effects of the financial market crisis were reflected in higher money market rates, which – owing to the high share of variable rate loans – pass through relatively quickly to consumer interest rates and consequently to interest expense. The favorable employment scenario in the labor market is not reflected in corresponding real income growth, and so has probably not improved households' capacity to meet their repayment obligations.

On the liabilities side there are still considerable exchange rate risks stemming from foreign currency loans, despite the decline in their share in total loans. In addition, since the majority of the foreign currency loans were issued in the form of bullet loans, the associated repayment vehicles are subject to significant valuation risks. These valuation risks remain in place even if the foreign currency loans are converted to euro loans.

Judging by financial market developments, households' risk exposure is likely to expand further over 2008.