Households

Higher Market Volatility Changes the Structure of Financial Asset Accumulation

In 2001, economic growth weakened markedly in Austria in the wake of international economic developments. Against this background, household real income growth decelerated in 2001, and real final consumption expenditure declined. Although the cyclical slowdown is likely to bottom out in the first half of 2002, income forecasts remain subdued for 2002, which is in part attributable to the worsened employment conditions. Households have also reduced their saving rate accordingly.

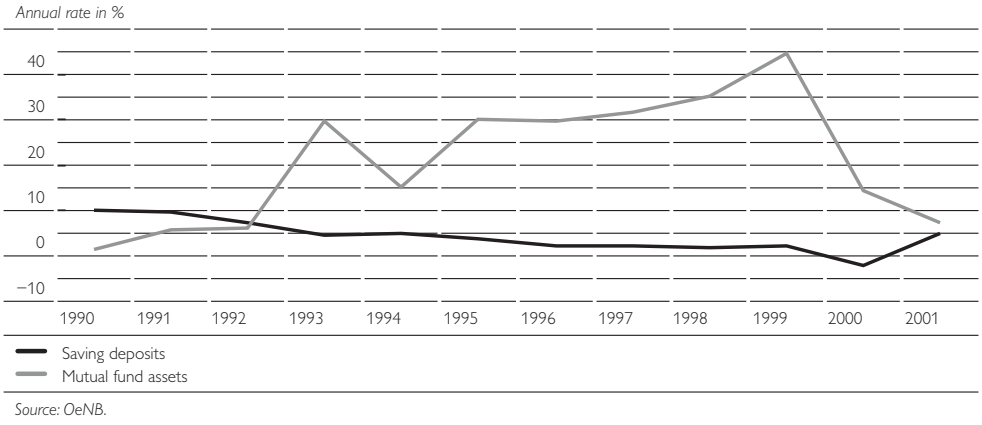
Given the growth setback, the accumulation of financial assets by households and their debt behavior was surrounded by greater uncertainty. Since the beginning of 2002, Austrian growth prospects have been improving and will cause the income expectations of households to brighten. Nonetheless, stagnating employment and higher unemployment are likely to continue to depress considerably household consumption and savings for the time being.

The share of marketable – notably foreign – financial instruments in household financial assets has been going up in the past few years, with investment in financial markets largely taking the form of mutual funds shares. At present, about 12% of private financial assets are managed by mutual funds. 58% of Austrian mutual fund assets are invested in foreign securities (EUR 57.3 billion at the end of 2001). Austrian investors have therefore also been hit by the price slumps on key international stock exchanges since 2000. Although Austrian mutual funds proved to be relatively resistant to the international price collapse, their performance was still substantially weaker than the year before. Compared to previous years, yields from insurance and pension fund investments also went down sharply, which might feed through to the financial position of households.

Faced with price losses and higher volatilities on stock markets, households showed renewed interest in savings deposits in 2001. The decline in the relative importance of deposits in the second half of the 1990s thus seems to have been reversed in 2001, at least for the time being. In 2001, the private sector[1]) raised

Figure 29

Growth of Savings Deposits and Mutual Fund Assets



Source: OeNB.

1 *In money and banking statistics, savings deposits of households and nonfinancial corporations are reported as one figure. It may be assumed that the majority of deposits is held by households.*

its savings deposits by EUR 5.6 billion or 4.7% after a decline of EUR 2.6 billion or 2.2% in 2000. Preliminary data on the stocks of financial assets confirm that households showed an increased preference for liquidity in 2001. In part, the euro cash changeover favored deposit growth, as substantial cash holdings were paid into sight and savings accounts in the wake of the currency conversion. Insecure market perspectives, however, also played an important role in driving up deposits.

Although the financial wealth of households has been influenced by market developments in recent years, the adverse price developments of 2001 are not likely to have had severe impacts on the overall economic financial position, as, on the whole, households have adequate financial assets – as reported in the previous two editions of the Financial Stability Report of the Oesterreichische Nationalbank (OeNB). A deterioration might have occurred with savings schemes that are used as repayment vehicles for foreign currency loans and more generally with funds that serve as collateral.

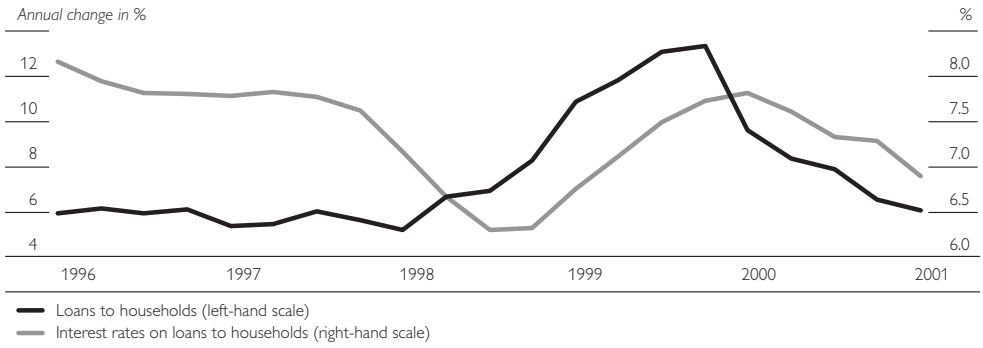
Household real property assets should not have suffered any fundamental negative wealth effects, either. No data are yet available for 2001, but the real estate price index, serving as an indicator of real wealth effects, has for years been following a positive trend characterized by slight volatilities. It may thus be presumed that no substantial real wealth losses did occur in 2001 that might have sustainably impaired the overall financial wealth of households.

Economic Slowdown Depresses Loan Demand

Subdued consumer confidence in the wake of the economic downtrend noticeably dampened the loan demand of households in the fourth quarter of 2001. Short- and medium-term consumer loans, in particular, posted reductions.[1]) By contrast, long-term bank financing of household consumption picked up 13.2%, although durable consumption declined in real terms in 2001. With interest rates being low, households obviously debt-financed a larger proportion of their long-term purchases. Alternatively, this may imply that debt maturities were extended or that short-term financing instruments, such as overdraft

Figure 30

Loans to Households – Growth and Interest Rates



Source: OeNB.

1 *Consumer loans with a maturity of up to one year diminished 2.3% in the last quarter of 2001 year on year, whereas loans with a maturity of one to five years dropped 3.6%.*

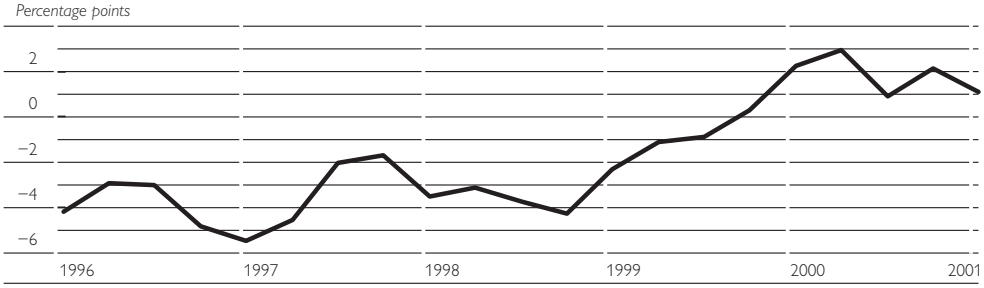
facilities on current accounts, were transformed into long-term loans. The development of private bankruptcies also supports this view. While private bankruptcies went down 1.4% in the first quarter of 2002 year on year, bankruptcy petitions that were dismissed as a "no asset case" jumped by one third.

Growth of housing loans, which constitute a major part of the financial liabilities of households, went down as well. Given the considerable weight of housing loans in household budgets, economic downtrends are able to quickly feed through to the liquidity of borrowers in this context.

Since the end of 2000 households have been significantly less inclined to take out major loans (in excess of EUR 350,000). Since then such loans have been growing more slowly than overall loans to households. The subdued income expectations are likely to contain demand for major loans. As in the case of long-term home financing, the currently low interest rate level might have risk-reducing effects.

Figure 31

Growth Difference Between Total Loans and Major Loans to Households



Source: OeNB.

The capability of households to service their debts is increasingly being influenced by exchange rate developments, too, as foreign currency debt keeps climbing. The growth of foreign currency borrowing should be closely observed; after all foreign currency personal loans have lately accounted for almost 25% of all loans extended to households. As households are less well placed to hedge against exchange rate risks than businesses, the former tend to incur higher risks when taking out foreign currency loans.

The financial market position of households remained virtually unaffected by the overall economic cooling in 2001. Although the reduced saving rate led to a slower accumulation of real and financial wealth, the stock of household financial assets continues to be high. The negative price developments might in part have affected the adequacy of assets as collateral. Stagnating income and bad employment prospects dampened loan demand and thus debt growth. But, at the same time, the servicing of existing debt became more difficult.

Nonfinancial Corporations

In the corporate sector, the international economic downturn in the past year largely translated into a drop in exports. The decline in export growth and the uncertain development of demand and earnings caused many corporations to delay investment projects. According to the WIFO investment survey, corporate propensity to invest has been deteriorating substantially since the middle of 2001. This is also reflected in loan demand, the growth of which has been decelerating significantly since the second half of 2001.

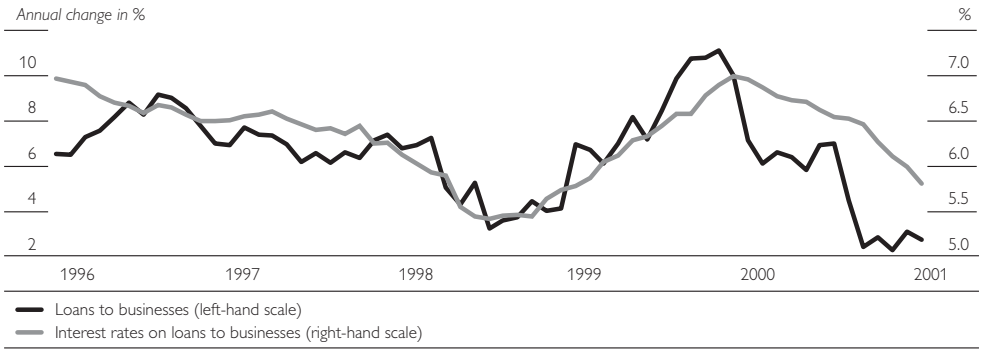
Higher investment demand is only to be expected after a revival of exports. Business surveys had revealed a marked clouding of the business climate in manufacturing in the fourth quarter of 2001, but in the first quarter of 2002 industrial corporations assessed the economic situation much more favorably, and the majority of respondents expect an output rise for 2002. In 2001, corporate loans only picked up 2.7% year on year, after a growth rate of 7.1% in 2000 (compare figure 32).

Businesses especially reduced loans with short- and medium-term maturities in 2001, whereas long-term loans maintained a high momentum at a growth of over 10%. As was observed with households, the extension of maturities might in part have been influenced by the unfavorable economic situation. Short-term liabilities might have been extended over longer periods to improve liquidity and avoid financial difficulties. Low interest rates and the flat yield curve until the first half of 2001 might also have contributed to the stronger demand for long-term loans.

The decline in short-term debt might also be attributable to a lower demand for operating credit as a consequence of reduced corporate turnover. Cash flow developments in key economic areas indicate higher liquidity requirements. In the wake of the economic downturn, the manufacturing cash flow ratio thus receded from 9.8% in 2000 to 9.6% in 2001.

Figure 32

Loans to Businesses – Growth and Interest Rates



Source: OeNB.

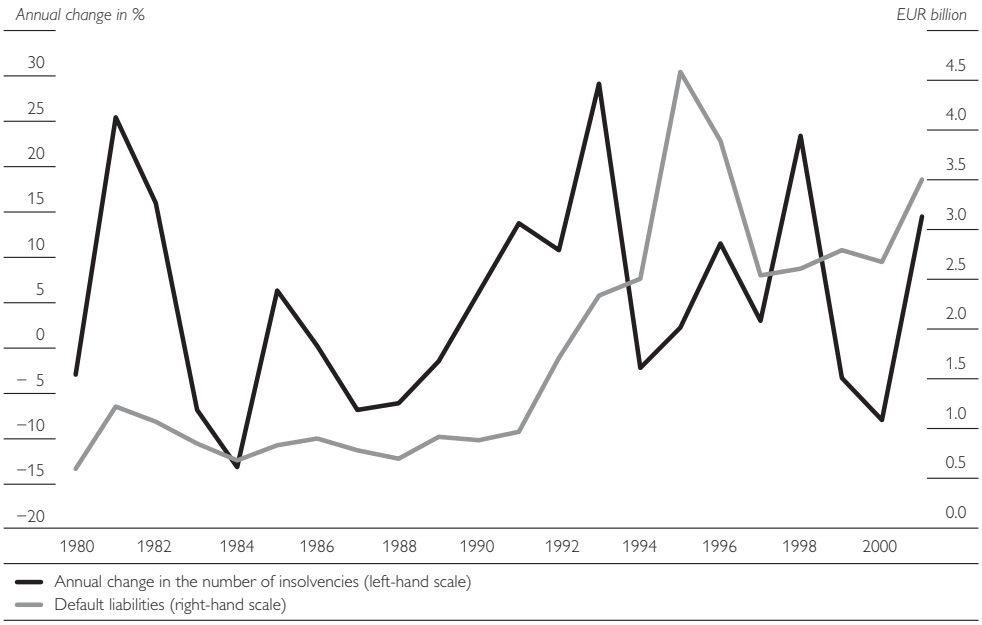
By contrast, interest rate developments eased the financing burden on corporations. Interest rates for corporate loans have been trending downward since the beginning of 2001 and have now reached end-1999 levels.

In parallel with the economic slowdown, corporate bankruptcies augmented in Austria. According to the Kreditschutzverband von 1870, total insolvencies picked up 14.5% in 2001. Bankruptcy growth continued in the first quarter of

2002 at 8.7% year on year. Default liabilities, however, fell behind 18% year on year, as no major businesses went bankrupt as at the beginning of last year – a development which might have pushed up default liabilities. From the perspective of the liabilities affected, the commercial failures in 2001 were less extensive and posed less threat to creditors of being dragged into bankruptcy as well.

Figure 33

Insolvencies and Default Liabilities



Source: Kreditschutzverband von 1870.

Smaller investment projects and the concurrent slower loan growth illustrate the pessimistic corporate sales expectations. Weaker loan demand and lower interest rates should help to keep a lid on corporate default probabilities. But, as the economy cools down, the likelihood of corporate insolvencies grows, which, in turn, leads to more prudent lending and worse credit ratings.

The Financial Accelerator in Austria

The financial accelerator theory states that weak balance sheets amplify adverse shocks to the economy by curtailing corporate investment. This implies two kinds of asymmetries: On the one hand, there are asymmetries over time, since balance sheets tend to be weaker during a downturn and financial constraints that are not binding during a boom may become binding during a downturn. The second asymmetry stems from the fact that companies that face significant agency costs of borrowing in credit markets, such as small, young or highly indebted firms, have weaker balance sheets. Thus, banks may ration credit to such financially constrained firms (either by cutting the loan supply or by increasing loan costs) more readily than credit to firms that are not financially constrained.

The importance financial factors have for investment and asymmetries in Austria has been analyzed by a number of papers[1]) drawing on balance sheet and income statement data that the OeNB collects in the course of its refinancing activities. The main results show that financial factors, along with the user cost of capital, are more important determinants of investment than the growth of sales. This finding implies that the worsening of economic conditions or changes in interest rates will be amplified by the so-called bank lending channel.

The studies also analyzed the asymmetry of the financial accelerator effect across groups of firms with different degrees of access to the financial market. Financial factors were found to be more important for small firms (because their capacity to collateralize their debt is limited) than for young firms, which tend to depend more on sales growth.

Moreover, the papers have confirmed the crucial importance of relationship banking, as banks can overcome informational asymmetries through a long-term relationship. Firms that have narrow and exclusive relationships with one bank are less prone to be financially constrained than firms that borrow from multiple sources. This is particularly true for small firms that have a house bank, but not necessarily for young firms; apparently an exclusive relationship must be validated over time.

The fact that investment by firms that have a house bank is less sensitive to balance sheet variables suggests that the prevalence of relationship banking in Austria offsets the effect of a reduction in the supply of loans following economic downturns or a tightening of monetary policy. However, as the data samples analyzed are biased toward solvent firms, these results must be interpreted with caution.

1 *See Valderrama, M. T. (2001). Credit channel and investment behavior in Austria: a micro-econometric approach. ECB Working Paper No. 108; Valderrama, M. T. (2001). Balance Sheet and Bank Lending Channels: Some Evidence from Austrian Firms. In: OeNB Focus on Austria 3+4; and Wesche, K. (2000). Is there a Credit Channel in Austria? The Impact of Monetary Policy on Firms' Investment Decisions, OENB Working Paper No. 41.*

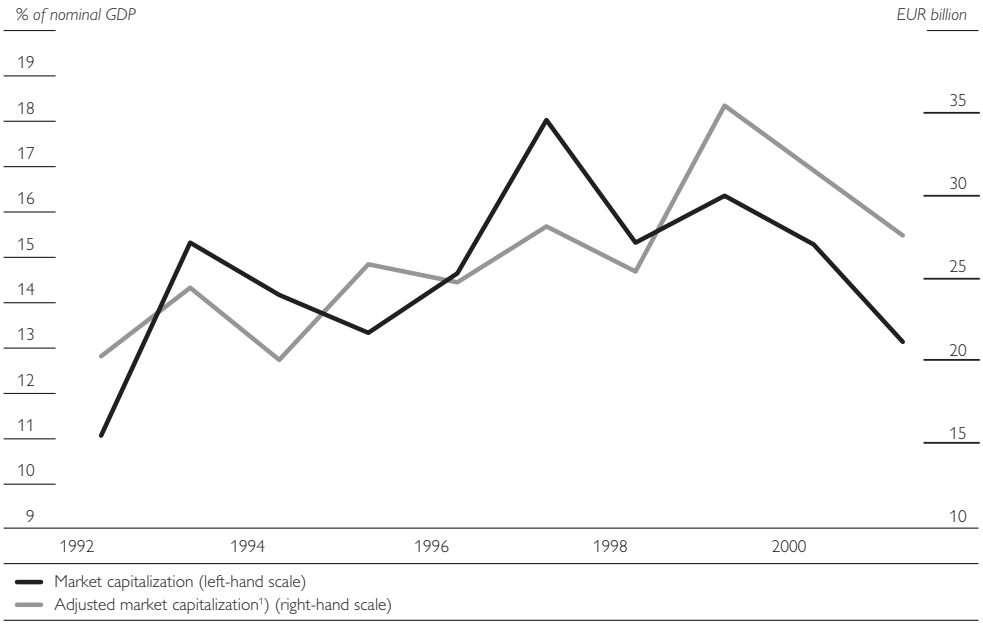
Stock Market

The Economic Significance of the Wiener Börse

In comparison to other European countries, raising money on the stock exchange plays a minor role in Austria. As illustrated by figure 34, the market capitalization of the Wiener Börse came to 13.1% in relation to GDP, thus being significantly lower than in almost all other European countries.[1]) The decline in market capitalization, observed in the past few years, continued in the first quarter of 2002. At the end of March 2002, the combined value of WBI-listed stocks (Wiener Börse index, contains all stocks listed in the official market) ran to EUR 27.7 billion, a year-on-year decline despite positive price developments. This is, in particular, ascribable to the fact that the listings of five businesses have so far been cancelled in 2002, while no new listings have been added. The price-adjusted market capitalization[2]) of the Wiener Börse has been trending downward since 1999.

Figure 34

Market Capitalization of the Wiener Börse



Source: Wiener Börse.
1) Market capitalization adjusted for annual price gains/losses.

Recently, the opinion has been gaining ground that the positive correlation between financial market structure (e.g. market- versus bank-based systems) and economic growth is less pronounced than that between the financial market structure and the industrial structure of an economy.[3]) For instance, the capital

1 *According to the World Federation of Exchanges, market capitalization in relation to GDP amounted to 72.1% in Germany and to 198.3% in the United Kingdom in 1999.*

2 *Price gains achieved after the issuance of shares may not be used for investments by the issuing corporations. Therefore, market capitalization adjusted for price gains/losses is a better indicator than nominal market capitalization.*

3 *The first paper to determine empirical evidence for such a correlation was: Carlin, W. and Mayer, C. (1999). How Do Financial Systems Affect Economic Performance? Mimeo, July 14.*

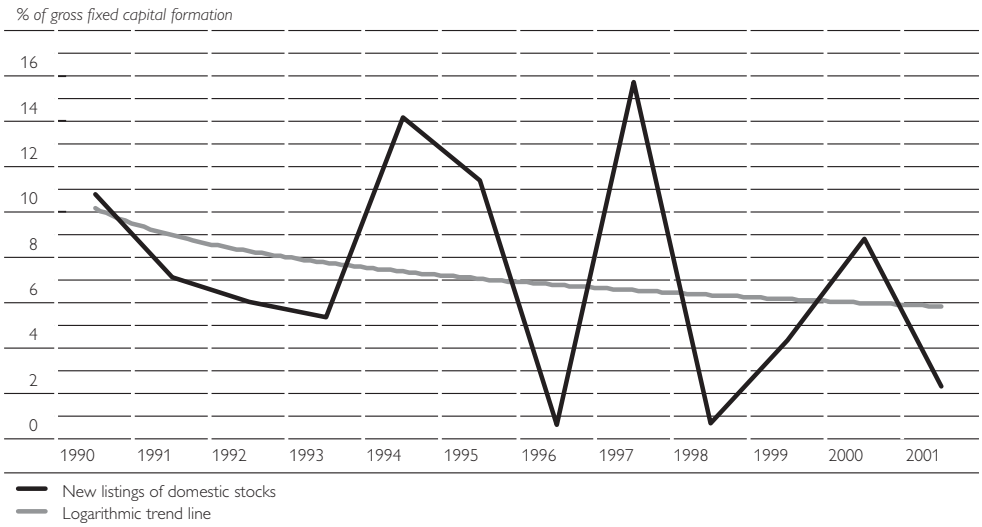
raised on the stock exchange is often plowed into long-term investment projects that will only yield positive returns after a start-up phase. New listings of shares are an indicator of the economic significance of a stock exchange, as these are also frequently used to finance innovations.

In order to measure the economic significance of exchange-financed innovations, we put them in relation to nominal gross investment in plant and equipment. As can be seen from figure 35, the volume of new issues floated at the Wiener Börse was subject to strong fluctuations in the past decade. Since 1990, however, we diagnose a slight downward trend. As a percentage of gross investment in plant and equipment, new issues in 2001 only came to 2.3%, thus lagging far behind the average of 7.3% in the period from 1990 to 2001.

Considering the downward trend of new listings at the Wiener Börse, the importance of the Austrian stock market for "innovative types of investments" seems to have gone down increasingly. This tendency, however, must be seen in the light of the growing impact of venture capital financing for businesses in the past few years. But Austria is nonetheless dominated by traditional industrial sectors with less pronounced research and development activities than are common in surging high-tech corporations, as for instance in the computer industry.

Figure 35

New Listings of Domestic Stocks at the Wiener Börse



Source: Wiener Börse.

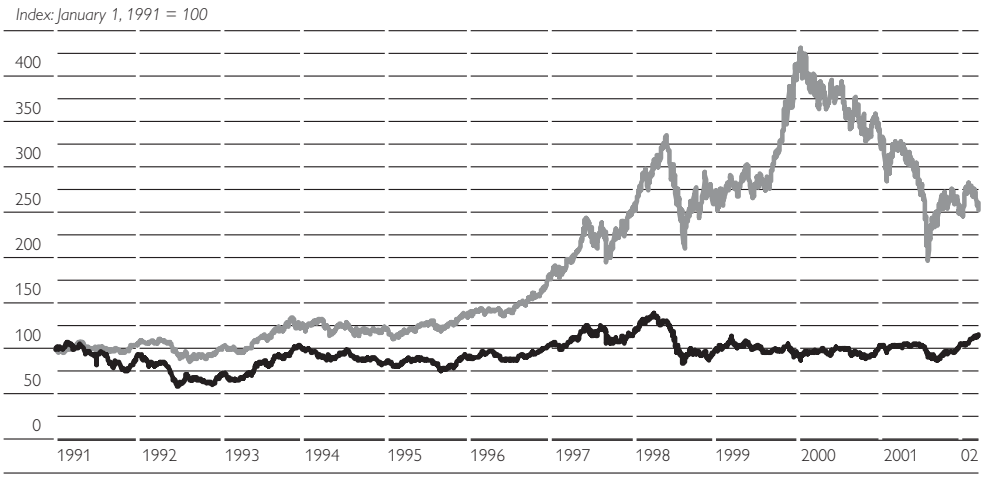
Positive Price Developments on the Vienna Stock Market

Since the beginning of 2002, the Vienna stock market has been trending upwards, with the Austrian Traded Index (ATX) up about 18% at the beginning of May 2002. Hence, ATX price developments did not evolve in sync with other European stock markets.[1]) The German stock index DAX and other European stock markets, by contrast, recorded price losses until the middle of February.

1 *Seen over a longer period of time, the Wiener Börse has been relatively independent of price developments in foreign stock markets as well. This is clearly reflected by the lower correlation of the ATX with stock indices abroad. Since the beginning of 2000, the correlation is even negative, i.e. price developments have evolved against the international trend.*

Figure 36

ATX and DAX



Source: Datastream.

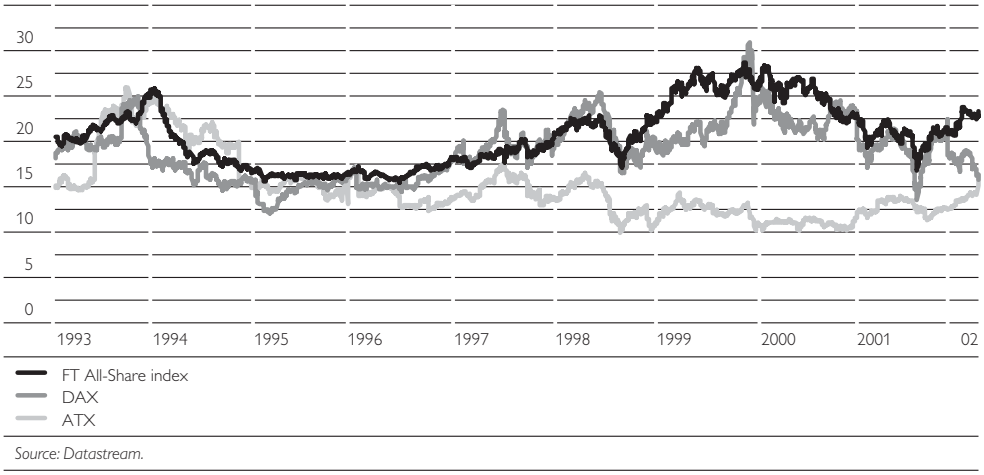
Austria has largely been spared the heightened stock market uncertainty caused by the bankruptcy of the U.S. energy corporate group Enron.[1]) Thus, Vienna only counted one eighth as many days with absolute price fluctuations exceeding 2% as Frankfurt between the beginning of 2002 and the first week in April.

The positive price performance of the Vienna stock market has largely also been carried by the sectoral setup of the ATX. In the first quarter "cyclical" stocks, such as VA Tech, Mayr-Melnhof or Vienna Airport, registered the

Figure 37

Price/Earnings Ratio

ATX, DAX and FT All-Share Index



Source: Datastream.

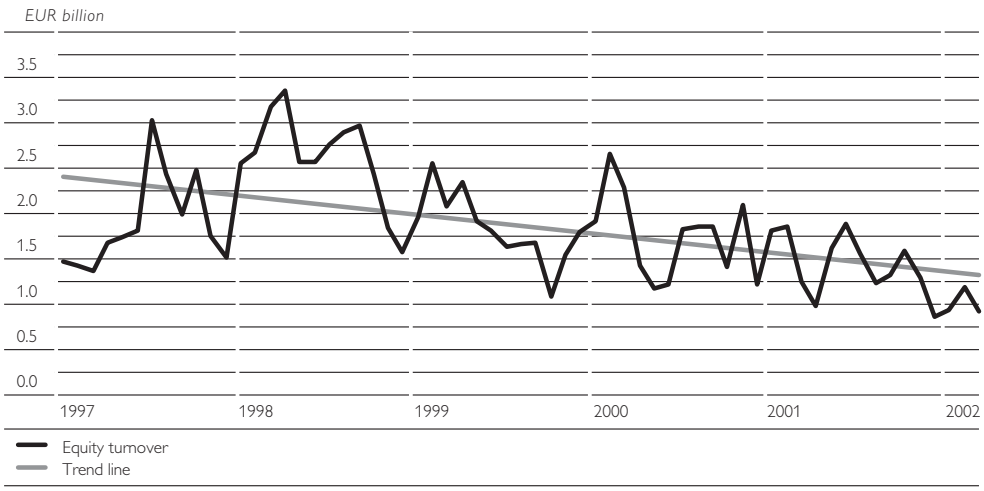
1 *The bankruptcy of the U.S. energy group Enron in December 2001, which, as a consequence, also dragged down the CPA firm Arthur Andersen LLP, triggered a European discussion on reporting and auditing systems. This was also mirrored in a higher implied DAX volatility.*

highest price gains[1]). In times of greater market uncertainty of investors, cyclical securities tend to be a lot less sensitive than growth stocks, such as telecommunication businesses, which – measured by the DJ Euro STOXX – had the largest impact on the decline of European stock indices.[2]) Also with regard to technology stocks, the Vienna stock market moved against the international trend. The securities that are combined in the growth index ViDX (Vienna Dynamic Index) picked up a little over 4% between January and the beginning of May 2002.

The positive ATX price performance has also caused the price/earnings ratio (P/E ratio) to rise since the beginning of 2002. At the beginning of May 2002, the ATX P/E ratio exceeded the mark of 16, thus leaving behind the 10 to 15 range that has been monitored since the fall of 1998. But in comparison to other European stock indices, there still remains room for further upward movement. In the first week of May 2002, the P/E ratio of the FT All-Share index, for instance, came to about 23. The current price performance could, therefore, not be interpreted as an "overestimation" of the Vienna stock market.

Figure 38

Equity Turnover at the Wiener Börse



Source: Wiener Börse.

Market liquidity on Wiener Börse, however, remains low. Equity turnover even retreated further in the first three months of 2002, only reaching 44% year on year and 63% of the average turnover of 2001.

1 *Farrell, J. L. (1983), Guide to Portfolio Management, McGraw-Hill, New York, differentiates stock-listed corporations, among others, into cyclical sectors and growth sectors. The stock development in cyclical sectors frequently shows a strong correlation to the business cycle. The performance of growth sectors, by contrast, is more dependent on the – not always fundamentally justified – expectations of financial players.*

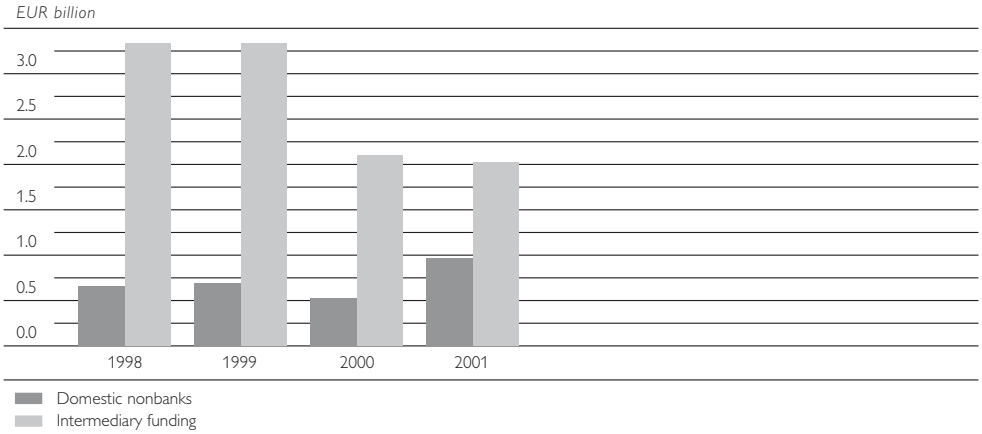
2 *From among the sectors of the DJ Euro STOXX, telecommunication stocks have registered the greatest price losses at 46% since the beginning of 2002. NEMAX, the Frankfurt index for growth and technology stocks, has been plummeting about 22% since the beginning of 2002. Receding sales figures for mobile phones and personal computers worsened the investment climate for technology stocks.*

Bond Market

The Austrian bond market continued to thrive in 2001. According to the OeNB issuance statistics, which do not contain foreign issues of Austrian issuers, gross issues came to about EUR 29.6 billion in 2001. With a (gross) issuing volume of about EUR 14.8 billion or 50% of overall issues, the central government was the top player on the domestic bond market, followed by banks with about EUR 13.8 billion or 47%. Corporations increasingly financed themselves by the issuance of bonds in 2001. At about EUR 960 million, other domestic nonbanks[1]) issued about 3% of overall gross issues, that is almost twice as much as in 2000.

Figure 39

Gross Issues by Domestic Nonbanks and Intermediary Funding by the Central Government



Source: OeNB, Federal Debt Committee.

It may be postulated that the tendency of Austrian businesses to directly tap the capital market will further intensify, not only on the domestic, but also on the European capital market, which is integrating rapidly. According to the financial accounts, more than 70% of Austrian corporate bonds were held abroad in 2000. We also have to take into consideration that the central government has been financing third parties since 1998 by issuing bonds and relending them under unchanged conditions to public-owned entities. At the end of 2001, such intermediary funding programs reached a new peak at EUR 9.6 billion. Against 2000, this means an absolute increase of about EUR 2 billion. Thus, the actual share of nonfinancial corporations in the overall volume outstanding of Austrian issuers is substantially higher.

1 Other domestic nonbanks include issues by the electricity sector, the industry and other domestic issuers.