

# Financing Conditions Stabilize for Real Economy

## First Signs of Easing in Corporate Financing

### Economic Recovery in Austria over the Year 2010

After stagnating in early 2010, the Austrian economy resumed its recovery toward the middle of the year. The main drivers of this development were the rebound of the world economy and in particular the robust economic growth observed in Germany. The dynamic growth in exports mainly benefited the Austrian manufacturing sector. In fact, by mid-2010 this sector had already made up half of its previous slump in production, which had dropped by some 20% in the course of the crisis. Thanks to marked improvements in manufacturing capacity utilization, the contractionary phase of the investment cycle came to an end in the third quarter of 2010. This investment growth was driven by investments in equipment, while construction investment continued to decline.

From the second half of 2009 onward, the substantial improvement in the economy also fueled a recovery in corporate profits, which had shrunk considerably during the crisis. In the third quarter of 2010, gross operating surplus (including mixed income of the self-employed) was up 8.5% year on year.<sup>1</sup> Not only was this growth important for the stability and creditworthiness of Austrian companies, it also buoyed their internal financing potential.

## External Financing Sees Another Slight Gain

The corporate sector's external financing has also shown a slightly more dynamic development in 2010 compared to 2009. According to national financial accounts data, the volume of external financing came to EUR 4.1 billion<sup>2</sup> in the first half of 2010, which was approximately one-quarter higher than a year earlier. However, this figure was still nowhere near the levels reached prior to the crisis. This growth was driven by the increased use of equity instruments, the volume of which climbed from EUR 0.4 billion to EUR 2.2 billion. At the same time, debt financing slackened in comparison to the first half of 2009, falling from EUR 2.9 billion to EUR 1.8 billion. Thus the share of equity in the corporate sector's total liabilities augmented to 55% in the first half of 2010.

## Bank Lending Bottoms Out

In recent months, bank lending has begun to show some signs of recovery. According to MFI balance sheet statistics, the annual rate of change in Austrian bank lending (adjusted for reclassifications, changes in valuations and exchange rate effects) had stopped declining by the end of the third quarter of 2010 (September 2010:  $\pm 0.0\%$ ).<sup>3</sup> Short-term loans have continued to decline, while lending at longer maturities has gained momentum in the course of the year. At the same time,

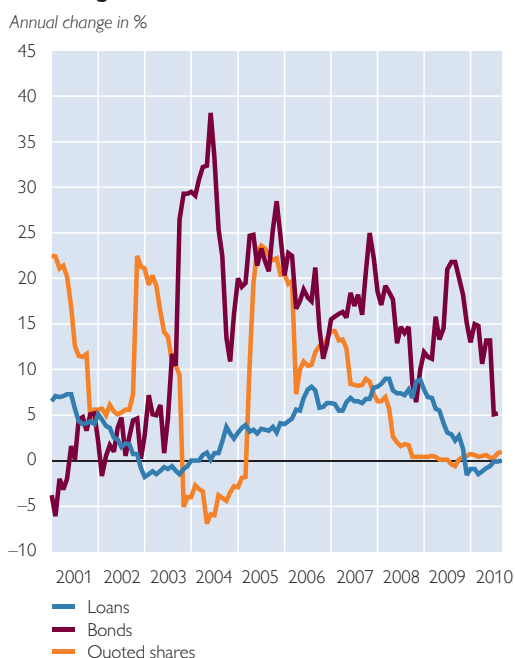
<sup>1</sup> This figure refers to the Austrian economy as a whole. Quarterly values are not published for individual economic sectors.

<sup>2</sup> Adjusted for foreign-controlled holdings in special purpose entities (SPEs).

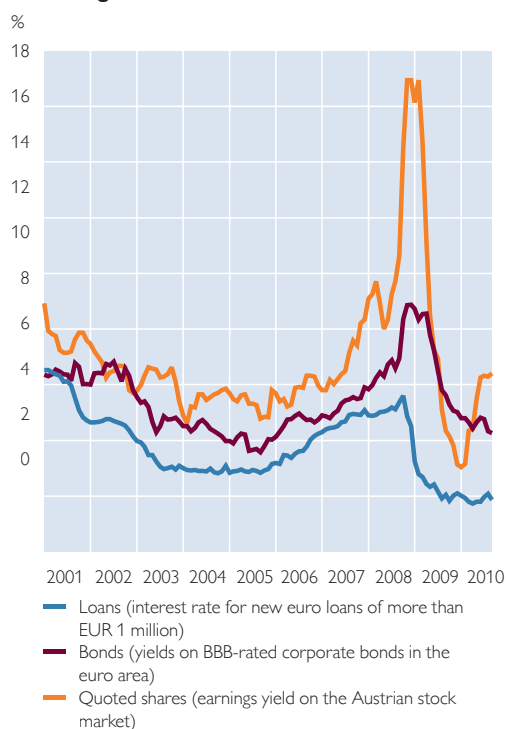
<sup>3</sup> For more information on the development of bank loans, see the OeNB's lending report (*Kreditbericht*; available in German only).

## Volumes and Conditions for Key Elements of Corporate Financing

### Financing Volumes



### Financing Conditions



Source: OeNB, Thomson Reuters, Wiener Börse AG.

net borrowing has returned to positive levels, meaning that bank loans made a slightly positive overall contribution to growth in the corporate sector's external financing.<sup>4</sup>

This recovery appears to be rooted in both the supply and demand sides. On the one hand, demand for loans has strengthened on the back of growth in investments. On the other hand, the results of the Eurosystem Bank Lending Survey for Austria indicate that banks have not tightened their credit standards any further since mid-2009. In absolute terms, however, corporate lending conditions can still be considered restrictive by historical comparison, as they were tightened steadily between mid-2007 and mid-2009. This

caution primarily reflects the banks' still-careful assessment of corporate creditworthiness in the current economic environment.

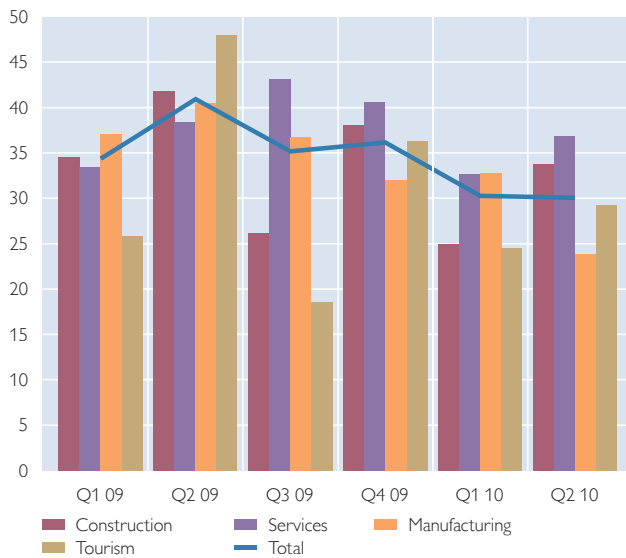
The number of companies for which access to financial funds has become more difficult due to deteriorated creditworthiness indicators continued to sink in the first half of 2010. Between the beginning of 2009 and mid-2010, the Austrian Institute of Economic Research (WIFO) regularly carried out special surveys commissioned by the OeNB on current lending terms and conditions in Austria. On the one hand, these surveys have revealed that the share of companies facing tighter lending conditions was consistently far higher than that of

<sup>4</sup> As national financial accounts data were available through the second quarter of 2010 at the time of writing, the figures on growth contributions refer to the first half of 2010.

## Net Share of Companies Reporting Tighter Lending Conditions for New Loans

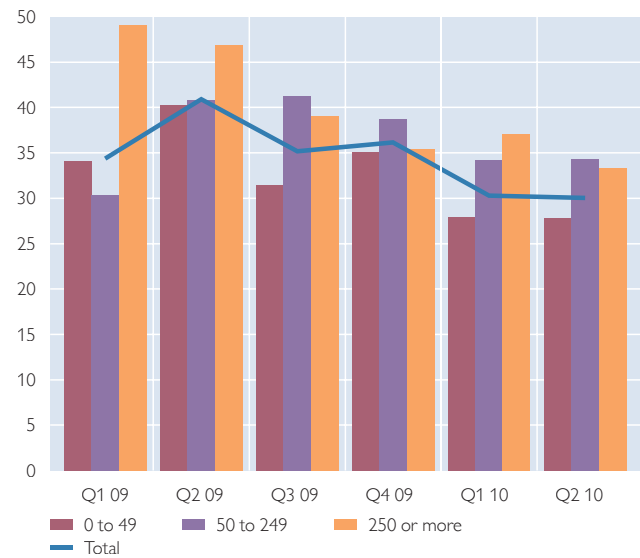
### Industries

Shares in %



### Number of Employees

Shares in %



Source: WIFO.

companies reporting an easing of credit terms. At the same time, the survey results also indicate that the former share has diminished markedly since mid-2009. This relaxation of credit terms was observed in all industries and in companies of all sizes, and it was especially pronounced in manufacturing and tourism. This trend suggests that access to financial funds is not likely to stand in the way of economic recovery in the enterprise sector.

Financing costs have continued to ease the burden on loan financing. In the third quarter of 2010, interest on lending remained at historically low levels after the massive key interest rate

cuts adopted by the ECB in 2008 and 2009. In September 2010, interest rates for new loans of up to EUR 1 million to nonfinancial corporations stood at 2.4%, while those for loans exceeding EUR 1 million came to 1.9%, i.e. in both cases more than 3½ percentage points lower than in October 2008.

In contrast, foreign lending continued to slip, even though the net decline fell from EUR 1.3 billion to EUR 0.8 billion. This category mainly refers to intracompany loans, to issues of debt securities through financial subsidiaries abroad, and in part to loans from foreign banks.

### OeNB Lending Reports: Analyses of Bank Lending in Austria since Outbreak of Financial Crisis

As the crisis worsened in early 2009, more and more representatives of companies and interest groups noted that Austrian banks had adopted highly restrictive corporate lending policies. In response, the Austrian Federal Minister of Economy, Family and Youth and the governor of the OeNB agreed that the OeNB would cooperate with the interest groups in preparing a study on Austrian bank lending with a special focus on corporate loans. The first lending report appeared in April 2009. Given the persistence of tight lending standards, four more issues of the lending report had been prepared and published on the OeNB's website by November 2010. During the crisis, this report proved to be a valuable aid in discussing trends in bank lending and identifying problematic developments. In addition, the lending report serves as an important source of information for Austria's social partners, enabling them to incorporate insights from the report into their policy recommendations.

This publication is prepared jointly by the Statistics Department and the Economic Analysis and Research Department at the OeNB. Broadly speaking, the report is divided into three parts: a descriptive statistical section which presents an analysis of Austrian banks' lending to companies and households; a section which analyzes and interprets the latest available survey results on lending in Austria; and finally a special analysis section which identifies and examines current issues on the Austrian financial market. In addition to scrutinizing developments in bank lending, the descriptive statistical section also analyzes the development of interest rates on corporate and household loans as well as other sources of external corporate financing (foreign loans, borrowing on the capital market).

In the survey section, the lending report provides an in-depth review of the results of a WIFO survey commissioned by the OeNB on Austrian banks' lending conditions, as well as the results of interviews carried out on the same topic with a few selected large companies in various industries. In addition, the analysis includes the findings of a survey on lending conditions performed by the Austrian Federal Economic Chamber as well as the Bank Lending Survey (a quarterly survey of financing conditions conducted in all euro area countries).

In the issues published to date, the special analyses have addressed the following topics: development of the corporate bond market, description and objectives of the Austrian Act on Strengthening Company Liquidity (Unternehmensliquiditätsstärkungsgesetz – ULSG), the significance of the credit squeeze in a financial crisis (including an analysis and historical experience), the development of housing loan financing, deleveraging in the Austrian banking sector, as well as foreign currency loans and loans with repayment vehicles in the household sector.

As for bank lending, each issue of the lending report has discussed recent developments, which – between early 2009 and the first quarter of 2010 – were characterized by a sharp decline in the annual growth rate of loans to nonfinancial corporations and, to a slightly lesser extent, to households. In the second quarter of 2010, and even earlier in the case of households, this slump appeared to have hit bottom, as annual growth rates – albeit still in negative territory – began to climb. Overall, the unprecedented downturn in lending growth observed since early 2009 appears to have ended. In the real economy, this development was also accompanied by a severe slowdown in economic growth, especially in investment. Therefore, it would appear that much of the contraction in lending was triggered by the demand side.

On the supply side, the surveys mentioned above revealed that the corporate sector faced increasingly tight credit standards (e.g. restrictions on credit lines, on lending volumes, or on both; heightened information; and collateral requirements) after the outbreak of the crisis. This tightening of lending conditions also continued during the moderate economic recovery which materialized in the second half of 2009. However, like the lending downturn, this trend appeared to come to a halt in the first half of 2010, as the share of companies reporting tighter lending conditions has dropped substantially. At the same time, the number of companies which have reported an easing of credit terms is still low, meaning that the circumstances on the supply side still cannot be considered “normal.”

*In the wake of the key interest rate cuts adopted by the ECB since October 2008, the interest burden on Austrian companies and households has eased considerably. These cuts were passed on to new corporate lending very quickly for all interest rate fixation periods, whereas transmission to household loans with longer fixation periods was rather hesitant. This is mainly related to the unique institutional characteristics of housing loans in Austria: The bulk of these loans are granted by building and loan associations and also include escalator clauses for new lending, meaning that interest rate adjustments are delayed in these cases.*

*Several – mostly large – companies have opted to borrow on the capital market in order to compensate for the lower levels of loan financing since early 2009. Bond issues have risen markedly since that time and are now at a higher level than before the crisis. In contrast, equity financing through the stock market has stagnated at a very low level since mid-2008.*

### **Bond Financing Has Sagged Slightly**

In the first half of 2010, Austrian companies obtained approximately half of their external financing by issuing bonds. In this context, it is worth noting that a large share of Austrian bonds are issued by state-owned or quasi-public enterprises. As at mid-2010, some half of the bonds outstanding (and the bulk of large-volume issues) were those of enterprises in which the state holds a majority share. In the third quarter, corporate bond issues lost some of their momentum, and by September 2010, their annual growth rate had slipped to 8.3% according to securities issues statistics. In part, however, this contraction simply reflects the base effect arising from especially high issue volumes in 2009.

Bond yields have also remained at low levels. In September 2010, yields on BBB-rated bonds<sup>5</sup> weakened to 4.3% – a new low since the financial market turbulence reached its peak in the fall of 2008 – and subsequently edged up just 1 basis point in October.

### **Equity Financing Still Impaired**

The crisis continues to have severe effects on financing via the stock exchange. In the first nine months of 2010, the gross volume of new issues

(in the form of capital increases) was lower than that of delistings, which was also the case in the same period of the previous year. Net new issues thus remained in negative territory (–EUR 41 million). In the first half of 2010, quoted shares made practically no contribution to external financing, as had also been the case in the first half of 2009.

Measured in terms of the earnings yield (i.e. the inverse of the price-to-earnings ratio), the costs of raising capital on the Austrian stock market escalated in the course of the year, mirroring the recovery in corporate earnings. Between January and September 2010, the earnings yield jumped from 3.0% to 6.4%, only to edge down to 6.0% in October.

As over-the-counter equity financing saw relatively robust growth in the first half of 2010, enterprises raised some 55% of their external financing in the form of equity during that period. This figure is roughly equivalent to the average over the preceding years (2005 to 2009: 57%). The proportion of shares and other equity in the corporate sector's total liabilities remained unchanged at approximately 47% in the first half of 2010.

<sup>5</sup> As no time series is available for yields on Austrian corporate bonds, figures for the euro area are used here.

### Austrian Corporate Financial Strength Indicators Improve Slightly

Corporate financial strength indicators, which in some cases had deteriorated sharply in 2009 due to the crisis, stabilized or even improved slightly in the first half of 2010. This period saw the smallest expansion of corporate debt in five years, and the ratio of corporate debt to profits fell slightly thanks to the recovery in earnings. The debt-to-equity ratio remained relatively stable throughout the crisis.

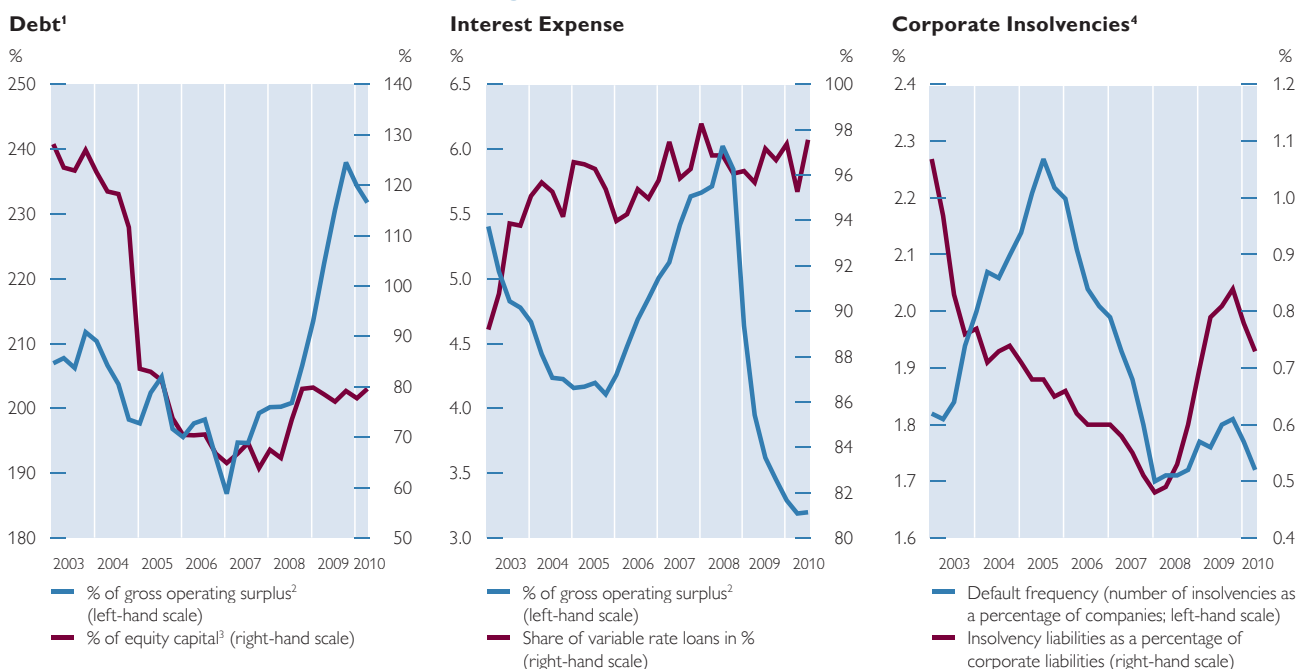
The subdued development in borrowing as well as the historically low level of interest rates are currently keeping interest expenses down in the corporate sector, which has provided relief on the cost side. However, even though this sector's debt-to-equity ratio remained steady throughout the crisis and the sector's exposure to interest

rate risk did not climb overall, rising interest rates could create a noticeable burden for highly indebted companies. This risk factor is all the more salient given that the Austrian enterprise sector exhibits an above-average share of variable rate loans, making the sector vulnerable to substantial interest rate risk.

In contrast, foreign currency-denominated liabilities have for years played a far less important role in Austrian corporate finance than in household borrowing. Low debt levels and low interest rates are probably also among the reasons why the number of corporate insolvencies has only risen relatively slightly in the course of the crisis. Based on moving four-quarter averages in order to rule out seasonal fluctuations, the number of insolvencies dropped 4.8% year on year in the

Chart 17

### Indicators of Corporate Financial Strength



Source: OeNB, ECB, Eurostat, Kreditschutzverband von 1870.

<sup>1</sup> Short-term and long-term loans, money market and capital market instruments.

<sup>2</sup> Including mixed income of the self-employed.

<sup>3</sup> Quoted shares and other equity.

<sup>4</sup> Moving four-quarter averages, annualized.

third quarter of 2010 and even declined slightly relative to the total number of companies. Insolvency liabilities also shrank in the first three quarters of the year. In relation to the total liabilities of the corporate sector (according to financial accounts), the four-quarter moving average of insolvency liabilities fell from 0.84% in the fourth quarter of 2009 to 0.72% in the third quarter of 2010. At the same time, it is important to note that insolvency figures generally constitute a lagging economic indicator.

### Financial Investments of Households During the Crisis

#### Households Boost Financial Assets

As at end-2009, the household sector held financial assets amounting to EUR 474 billion, or 1.7 times Austria's GDP. In a breakdown, the financial assets of households (self-employed persons and

private individuals) totaled EUR 440 billion (93% of the overall amount). Private foundations, which are recorded as part of the household sector in Austria's financial accounts, held EUR 27 billion in financial assets (6% of the total).

In June 2010, financial assets of households (excluding nonprofit institutions serving households) reached a total of EUR 447 billion, up EUR 7.1 billion (1.6%) from the beginning of the year.

#### Households Cut Back on New Investments in First Half of 2010

During the financial crisis, saving decelerated in the household sector. Although wages and salaries rose only moderately, consumer spending remained stable during the crisis, which in turn put downward pressure on the saving rate. In 2009, this rate sank from

Table 2

### Breakdown of the Household Sector's Financial Assets as at End-2009

|   | Household sector |                              |  |                     |   |                     |                     |
|---|------------------|------------------------------|--|---------------------|---|---------------------|---------------------|
|   | Total            | Households (excluding NPISH) |  |                     | Nonprofit institutions serving households (NPISH) |                     |                     |
|   |                  | Total                        | Self-employed persons and sole proprietorships | Private individuals | Total   | Private foundations | Other organizations |
| <i>in Mrd EUR</i>                                 |                  |                              |  |                     |   |                     |                     |
| Currency <sup>1</sup>                             | 15.7             | 15.7                         | x  | x                   | 0.0   | x                   | x                   |
| Deposits with banks in Austria and abroad         | 210.7            | 204.4                        | 13.5   | 190.9               | 6.3   | 5.0                 | 1.3                 |
| Memorandum item: Savings deposits in EUR          | 156.4            | 156.4                        | 0.0  | 0.0                 | 0.0   | x                   | x                   |
| Tradable securities <sup>2</sup>                  | 102.8            | 88.2                         | 5.0  | 83.2                | 14.6  | 10.3                | 4.3                 |
| Other equity <sup>3</sup>                         | 43.7             | 30.4                         | x  | x                   | 13.3  | 11.8                | 1.5                 |
| Life insurance reserves and pension fund benefits | 80.6             | 80.6                         | x  | x                   | 0.0   | x                   | x                   |
| Other financial assets <sup>4</sup>               | 20.8             | 20.6                         | x  | x                   | 0.2   | x                   | x                   |
| <b>Total financial assets</b>                     | <b>474.3</b>     | <b>439.9</b>                 | <b>0.0</b>                                     | <b>0.0</b>          | <b>34.4</b>                                       | <b>27.0</b>         | <b>7.2</b>          |
| Change since 2005                                 | 82.3             | 70.4                         | x  | x                   | 11.9  | x                   | x                   |

Source: OeNB.

<sup>1</sup> Cash cannot be subdivided, thus 100% of this item is currently attributed to households.

<sup>2</sup> Debt securities, quoted shares and mutual fund shares; broken down according to securities holdings reports of Austrian banks.

<sup>3</sup> Nonquoted shares and other equity (at book values).

<sup>4</sup> Cash in Austrian schillings, claims on severance funds and claims on insurance companies from damage and accident insurance policies.

11.8% to 11.1%, and the figures currently available for the year 2010 point to a further decline.

In recent years, household savings have exhibited a high correlation with financial investment. Accordingly, these investments also decelerated along with the lower propensity to save observed in households (self-employed persons and private individuals). In the first half of 2010, household savings amounted to a mere EUR 5.7 billion (compared to EUR 9.6 billion in the first half of 2009).

Until the peak of the financial crisis, retail investors mainly focused their activities on longer-term financial products. These included bank deposits as well as debt securities issued by banks. However, this trend changed substantially starting in the first quarter of 2009, when households began to shift their asset portfolios toward more liquid investments. This development can probably be attributed not only to

uncertainty, but also to the low level of interest rates.

Households began to invest in securities again after the peak of the financial crisis; these investments totaled EUR 1.2 billion in the first half of 2010. During that period, retail investors mainly purchased Austrian stocks and corporate bonds. However, these investors have also added more mutual fund shares (mostly in foreign funds) to their portfolios since the year 2009.

Investments in life insurance policies and pension fund reserves have continued to show steady growth. The growing importance of funded pension instruments per se as well as their use as repayment vehicles for bullet loans has supported investment in this type of product, although new foreign currency lending has slowed markedly compared to 2009.

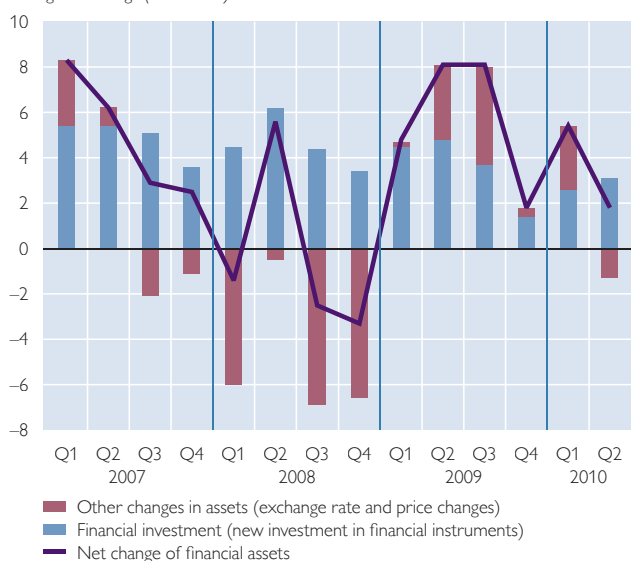
A fair amount of the growth in household financial wealth since the end of 2008 can be attributed to the

Chart 18

## Household Financial Assets

### Growth Due to New Investment and Price Effects

Change in holdings (EUR billion)



Source: OeNB.

### Financial Assets

Holdings (EUR billion)

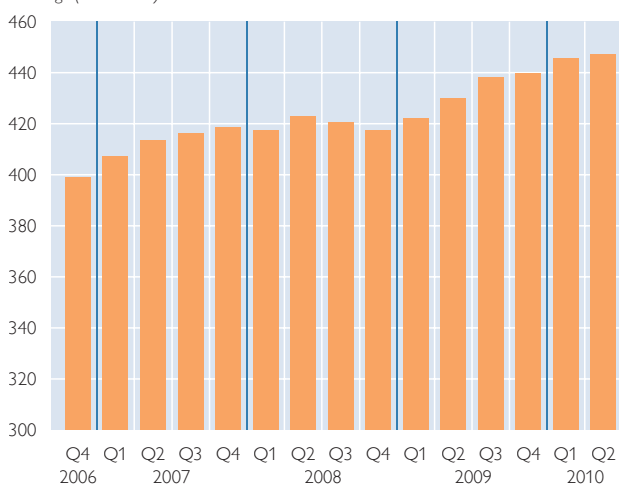


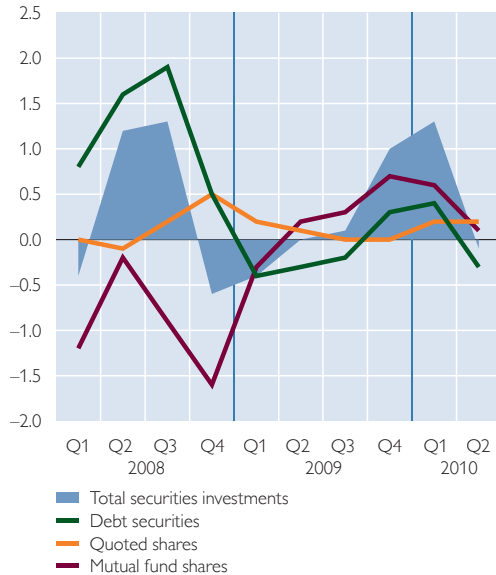


Chart 19

## New Investment in Securities by Households

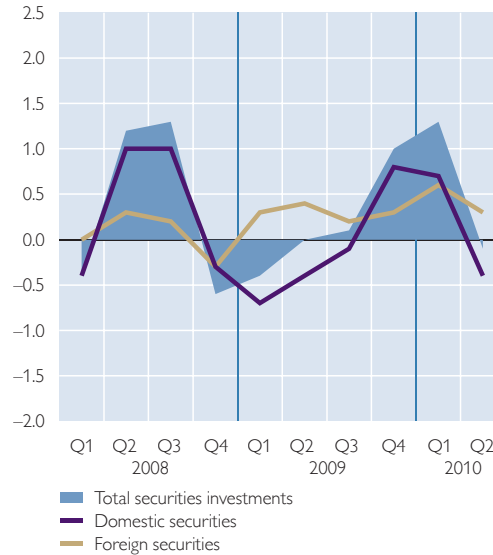
### By Instrument

Transaction volume (EUR billion)



### By Country of Issuer

Transaction volume (EUR billion)



Source: OeNB.

rebounding prices of quoted shares and mutual fund shares. In the first half of 2010, net (unrealized) price gains came to approximately EUR 1 billion (for households excluding nonprofit institutions serving households). Therefore, approximately EUR 10 billion of the dramatic price losses during the crisis (over EUR 23 billion between mid-2007 and the first quarter of 2009) were offset between the second quarter of 2009 and the second quarter of 2010.

### Property Income Remained Considerable Even During the Crisis

According to national accounts data, the household sector's property income is part of disposable income. This category includes distributed income of corporations, interest income from deposits and securities, and property income attributed to insurance policy

holders. However, a number of problems are associated with these data.

First, the crisis had a severe effect on property income, which (after deduction of interest paid on loans) shrank by 29% in 2009. The main reason for this development was a sharp contraction (–39%) in distributed income of corporations, which accounted for nearly two-thirds of the decline. More than one-third of the reduction in property income in 2009 can be attributed to interest income. Interest rates fell primarily as a result of the ECB's rate cuts in 2008 and 2009 in response to the crisis.

Despite the sharp decrease in the crisis year 2009, net property income still exceeded EUR 16 billion, thus accounting for just under 10% of disposable income. For the majority of households, however, property income plays a secondary role at best. In addition,

the problems associated with property income data are formidable. For example, the distributed income of corporations is calculated as a residual value.<sup>6</sup>

### Only Weak Growth in Loans to Households

The first half of 2010 saw sagging demand for loans as well as more cautious lending policies on the part of the banks. Housing loans remained the focus of demand, while consumer loans declined. At the end of June 2010, outstanding bank loans<sup>7</sup> to households amounted to EUR 134 billion, up 4.8% year on year. At the same point in time, the total liabilities of retail borrowers – including liabilities to other lenders (especially in the form of home loans granted by the public sector) – came to EUR 157 billion.

### Financial Crisis Has Worsened Households' Risk Situation

Despite the low volume of new borrowing and low interest rates, the debt burden on households rose noticeably during the crisis because disposable income was weak. In the second quarter of 2010, Austrian households' debt amounted to 97% of their disposable income (euro area: 102% in the fourth quarter of 2009), which was approximately 10 percentage points higher than in mid-2008.

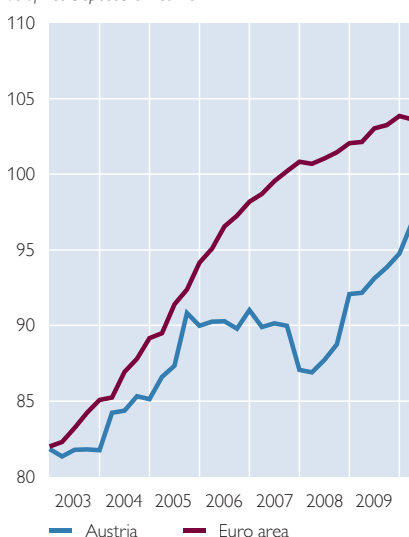
Thanks to interest rate cuts, interest expenses dropped from 4% of disposable income in the fourth quarter of 2008 to 2.4% in the second quarter of 2010. At the same time, however, the share of variable rate loans in new lending climbed steadily. This type of loan accounted for 87% of outstanding loans

Chart 20

## Household Risk Indicators

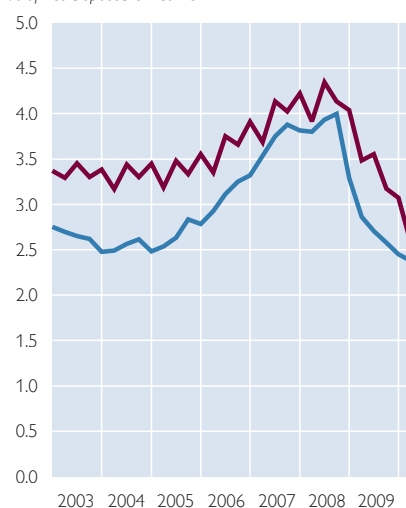
### Liabilities

% of net disposable income



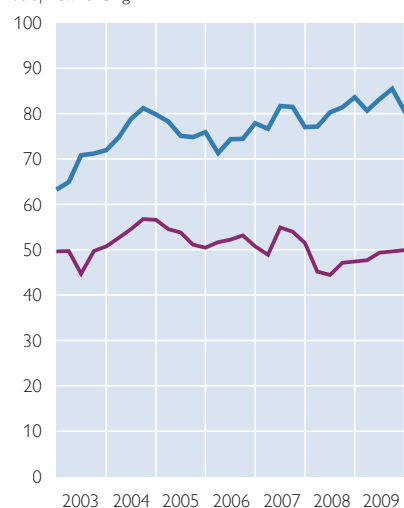
### Interest Expense

% of net disposable income



### Variable rate loans

% of new lending



Source: OeNB, ECB, Eurostat.

<sup>6</sup> Only the dividend payments made by stock corporations are surveyed directly. Data are not collected on withdrawals of income from limited liability companies and partnerships. Income attributed to insurance policy holders is a notional value which reflects the performance of investments by insurance companies and pension funds.

<sup>7</sup> Including the home loans purchased by banks from 2001 onward.

in the second quarter of 2010. This share, which is very high by international comparison, has helped households reduce their interest expenditure more quickly in the last year and in the first half of 2010 thanks to the speed with which the ECB interest rate reductions were transmitted to lending rates. However, those rates could surge again just as quickly if interest rates were to climb.

The persistently high share of foreign currency lending to households poses another risk associated with fluc-

tuations in exchange rates and in the value of repayment vehicles. Although it has diminished somewhat, the share of foreign currency-denominated loans in Austria remains very high compared to the euro area average. In the second quarter of 2010, foreign currency loans constituted 30% of the household sector's overall loan volume. This risk factor becomes especially visible when the foreign currencies in question appreciate against the euro. Since the fall of 2008, the Swiss franc has picked up some 20% against the euro.