

## Nonfinancial Corporations Economy Recovers Faster

The economy recovered faster in the first half of 2004 with real GDP having increased by 1.4% over the previous year. Exports rose sharply owing to the recovery of the global economy and the stabilization of the euro exchange rate. After gross fixed capital formation had risen by 5.3% in 2003 – mostly attributable to replacement investment – investment demand was significantly weaker in the first half of 2004; real gross fixed capital formation increased by a mere 1.5% over the same period of the previous year.

The continued export boom, however, should have a favorable effect on investment demand during the remainder of 2004. The WIFO Investment Survey for 2004 indicated that much. According to the survey, gross fixed capital formation is expected to surge in the manufacturing industry as well as the utility and power industries. In the manufacturing industry real investment growth is expected to come to 5.8%. Thus,

the growth rate is lower than in the boom years of the 1990s.

## Equity Covers Most of External Financing Requirements

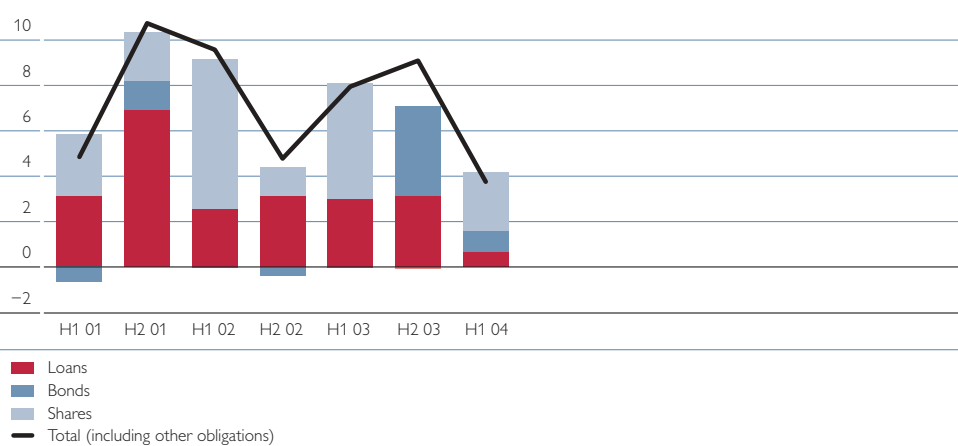
The soaring investment demand in 2003 also increased the need for financing in the corporate sector: The financial accounts statistics show that external financing – based on the fiscal balance of the corporate sector – increased again last year, after having declined sharply in 2002. In the first half of 2004, however, the need for financing was rather small; net borrowing at EUR 3.7 billion was lower than in the first half of 2003 (EUR 7.8 billion). According to first estimates in 2003, internal financing remained high owing to an increase in operating surpluses, but has slowed down somewhat since.

Companies met their extremely low requirement for funds in the first half of 2004 primarily by issuing securities. The proportion of loans in external financing decreased considerably. The figures shown in chart 11 include not only loans of

Chart 11

### External Financing of the Corporate Sector

Transactions in EUR billion



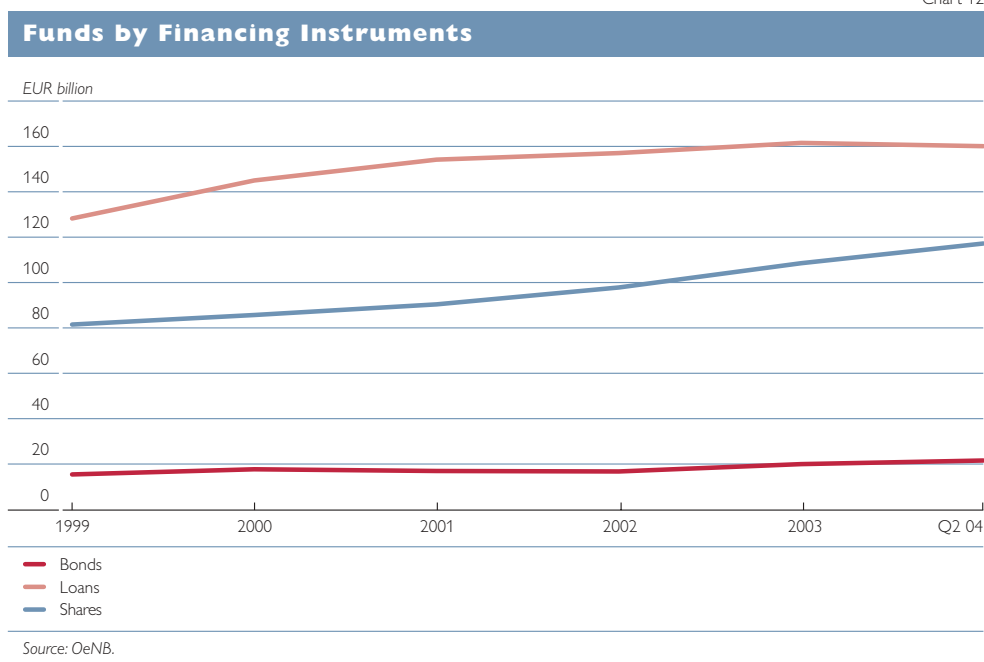
Source: OeNB.

domestic banks but also those of other sectors as well as of foreign lenders.

By mid-2004, the equity ratio had reached 38%, which is some 4 percentage points higher than three years earlier. Compared to the first half of 2003, the proportion of listed stocks in equity capital as a whole climbed from 24.3% to 27.8%. As the corporate sector also issued an increasing

number of bonds, direct corporate borrowing from the capital market covered as much as 45% of external financing in mid-2004 (bonds: 7%, shares: 39%). The proportion of loans in external financing has been declining but still accounts for some 52% of external financing. The remaining 3% were other liabilities.

Chart 12



#### Fairly High Share of Capital Raised on the Stock Exchange

Even though in net terms the stock exchange contributed little overall to equity capital financing, its gross contributions to raising capital augmented in the first half of 2004. The reason for the discrepancy between the gross and net amounts is that stocks were delisted, which further reduced the number of companies listed on the Vienna stock exchange (Wiener Börse) to only 83 at the end of the

third quarter of 2004. (Three years earlier, at the end of September 2001, as many as 100 companies had been listed.)

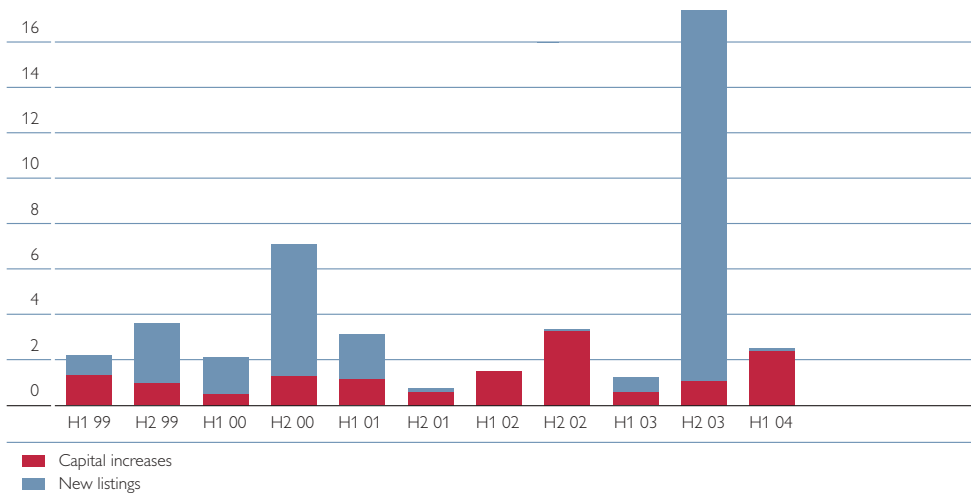
In the first three quarters of 2004, 11 companies made rights issues against cash or contributions in kind and raised some EUR 800 million in this way.<sup>44</sup> In addition, there was one new listing to the amount of EUR 24.87 million. Capital increases in the first half year thus accounted for 2.4% of the gross fixed capital formation of the economy overall

<sup>44</sup> Real estate corporations listed on Wiener Börse accounted for some 40%.

Chart 13

### Funds Raised on Wiener Börse

% of gross fixed capital formation



Source: OeNB.

The sharp increase in the second half of 2003 was caused by the new listing of Bank Austria Creditanstalt AG.

(see chart 13). While this is above the long-term average, it is still significantly lower than the average percentage in the euro area.

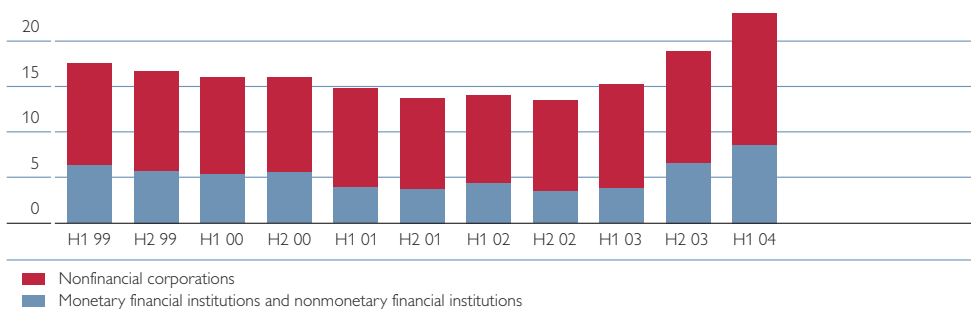
As a result of the capital increases but mainly owing to the substantially higher share prices – the ATX climbed 32% in the first three quarters, which is far more than most international stock exchange indices – market capitalization increased above average,

even though some stocks were delisted. At the end of September 2004 market capitalization amounted to about EUR 54.5 billion (23% of GDP), i.e. 20% up from early in the year. In spite of this increase, market capitalization remained fairly low by international standards, coming to approximately 50% of GDP in the entire euro area.

Chart 14

### Market Capitalization of Wiener Börse

% of GDP



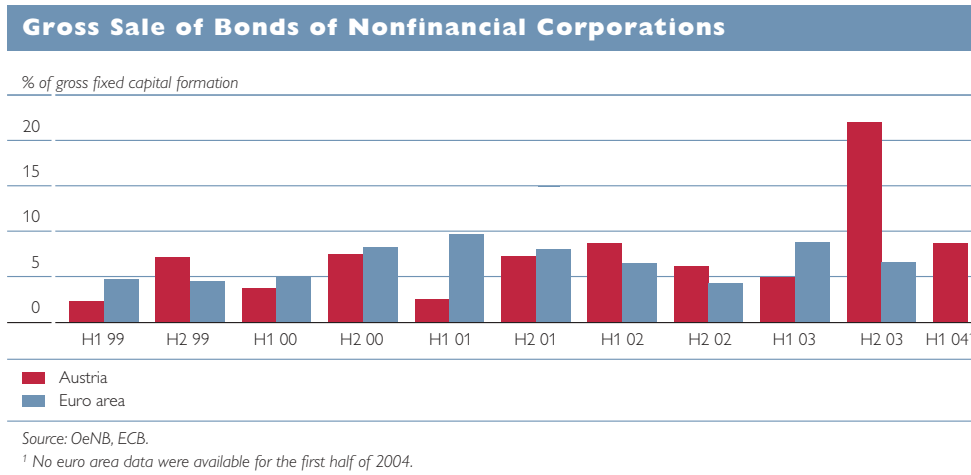
Source: OeNB.

In June 2004, nonfinancial corporations accounted for just over 60% of overall market capitalization of Wiener Börse, with their share having dropped by 10% since mid-2003 mainly as a result of the new listing of Bank Austria Creditanstalt AG in July 2003. By contrast, in the euro area the share of nonfinancial corporations remained stable at three quarters of overall market capitalization.

**Higher Share of Bonds in Corporate Funding**  
Bond issues in the first half of 2004 also accounted for a considerable

share of corporate funding. Even though bonds (domestic issues) accounted for only 7% of total funds, they accounted for more than 20% of the funds nonfinancial corporations raised in the first half of 2004. In this period, the net issuance volume accounted for some 4.3% of the gross fixed capital formation of the economy overall. While this was significantly below the 14% of the second half of 2003, it still exceeded the average since the first quarter of 2000 (2.1%) by far.<sup>45</sup>

Chart 15



### The Importance of Bond Issues for Corporate Funding in Austria

In the past few years the corporate bond market in Austria has developed considerably. While issuance activity used to be dominated by energy utilities and other quasi-public corporations, in recent years companies from other industries and, increasingly, smaller firms have also been issuing bonds. The securities database of the OeNB shows that at the end of 2003, a total of 160 companies had issued bonds worth between EUR 0.3 million and EUR 3.2 billion. In 2003, the funds raised by bond issues accounted for as much as 7% of all external financing in the corporate sector, which is a fairly high percentage compared with other countries in the euro area.

Data from the Major Loans Register show that in 2003, bond issues made up an average of about 52% of all external financing of the issuing companies. As a rule, bond issuance does not increase corporate debt but rather replaces bank loans as the borrowing instrument. By issuing bonds, a company may widen its creditor base beyond the range of banks. At the end of 2003, only just under 20% of all corporate bonds outstanding were held by (domestic) banks, some 70% by foreign investors.

<sup>45</sup> In the first three quarters of 2004 the Wiener Börse attracted six new listings of corporate bonds and there were two capital increases of existing bonds with a nominal value of EUR 366 million. Altogether, 64 corporate bonds were listed at the Wiener Börse.

Bonds are usually used for borrowing with a longer maturity than that of a bank loan. At the end of 2003, the original maturity of more than 80% of the bonds issued by Austrian corporations was more than five years. Unlike loans, where costs are basically proportional to the amount borrowed, costs related to a bond issuance are strongly degressive, owing to a number of one-off issuance costs. Therefore, this instrument is primarily an option for high-volume financing.

Bonds are less flexible than bank loans, as contract modifications (both by the creditor and the debtor) after issuance are virtually impossible; therefore, bonds require a level of creditworthiness of the issuer that is well above average. The fact that securities-based financing – unlike bank loans – is usually not secured by assets also suggests that, as a rule, it is available only to companies with a good credit rating.

Accordingly, there were only few defaults of corporate bonds in the past few years. This suggests that when they select bond issuers, at least the big issuing banks in Austria exercise a great sense of responsibility. So far, no speculative activities have been observed on the Austrian bond market. Owing to the stepped-up issuance of corporate bonds, the risk sensitivity of external financing has improved, as corporate bond prices usually reflect the inherent risk appropriately.

A detailed analysis of corporate bonds in Austria will be published in *Monetary Policy & the Economy Q4/2004*.

#### New Lending Volume Small

In the first half of this year, the corporate sector took out loans with Austrian banks with a net value of EUR 226 million, which is only a tenth of last year's reference value.<sup>46</sup> This decline is mainly attributable to the fact that a large number of short-term loans were repaid. A similar pattern was also observed in the first six months of 2001, 2002 and 2003.

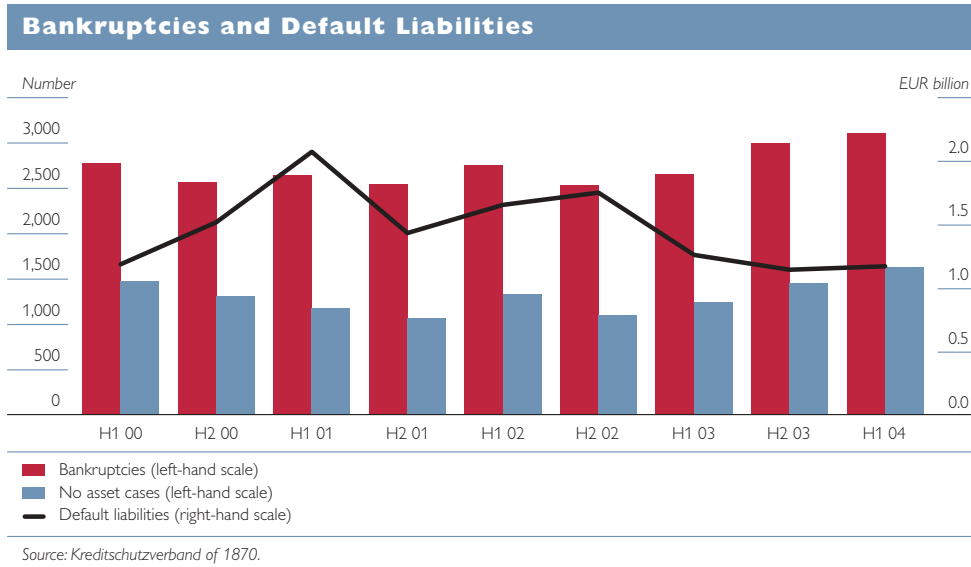
Corporate exposures (liberal professions excluded) started to decrease again in mid-year, after having grown for some months in the first half of 2004 in comparison to the previous year. This development corresponded to the Austrian results of the credit business survey, which found that in the third quarter of 2004 banks slightly tightened the standards for corporate exposures for the first time this year, after the favorable economic outlook had earlier led to a slightly relaxed lending policy.

#### More Bankruptcies

The credit information company Kreditschutzverband of 1870 (KSV) found that although companies' equity ratio was on the rise, the number of bankruptcies further increased in the first half of 2004 against the first half of 2003. In an analysis of the causes, the KSV cited a "lack of capital" as one of the main reasons for bankruptcy, even for the year 2003. The total number of bankruptcies climbed by 16.8%, the number of no asset cases even jumped by 31.6%, (chart 16). Estimated total liabilities dropped by 7.1% compared to the first half of 2003, but in light of the increasing number of no asset cases this cannot be considered a trend pointing toward a more solid financial situation of companies.

<sup>46</sup> The allocation of bank loans to sectors in the Financial Accounts is different from the allocation in the monthly report.

Chart 16



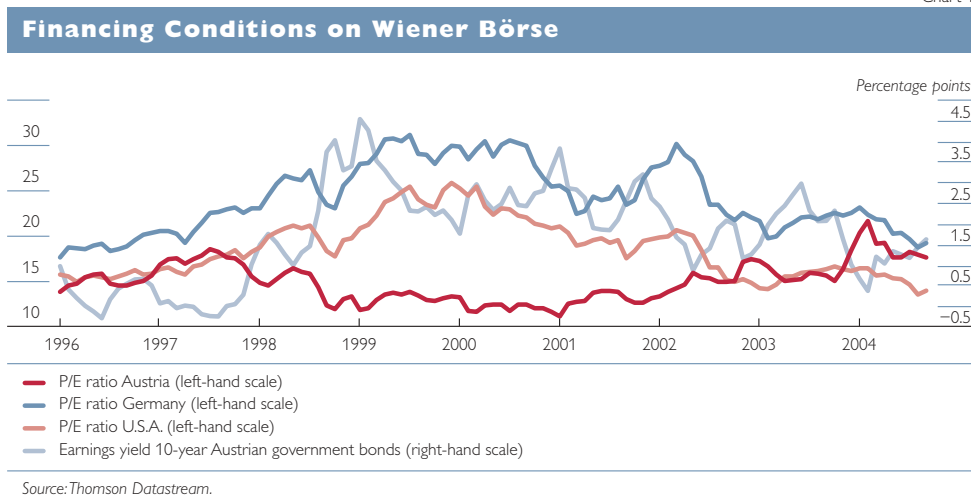
### Financing Conditions Remain Good

The conditions for external financing continue to be favorable for Austrian companies in 2004. Financing conditions at the Wiener Börse remained good in a long-term comparison, even though they deteriorated slightly in the course of 2004. The price-to-earnings ratio at Wiener Börse dropped in the second and third quarters (despite rising share prices) and made financing through shares slightly more expensive. At the same time, the price-to-earnings ratio has come

closer to the reference values of other markets in a long-term comparison, after having been far lower for a long time. Since November 2003, it has also been above its ten-year average of 15.9.

Another indicator for the financing conditions at the stock exchange, but also for estimating the risk markup of financing through the stock exchange, is the difference between the earnings yield, i.e. the reciprocal of the price-to-earnings ratio, and the yield of government bonds. In

Chart 17

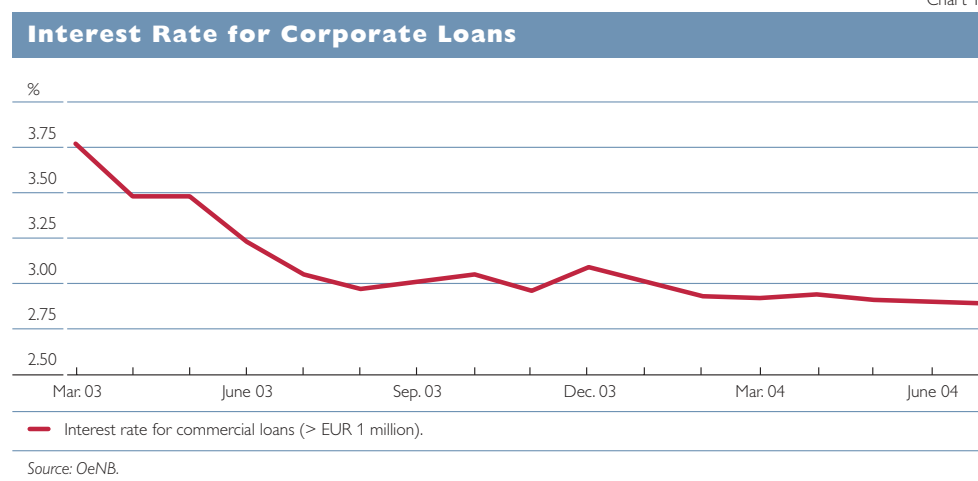


the first three quarters of 2004, this difference soared from 67 to more than 160 basis points, also owing to falling yields of government bonds. This suggests that in that period funding through shares became less attractive in relation to funding through loans or bonds.

Interest rates for corporate exposures also showed a favorable development. From the first half of 2003 to

the first half of 2004 lending rates dropped from an average 3.6% to 2.9% (see chart 18). The Austrian results of the credit business survey also suggest that the terms for corporate loans have been slightly eased in the course of this year. This affected mostly small and medium-sized enterprises, i.e. those enterprises that rely mostly on bank loans for external financing.

Chart 18



## Households

### Financial Investment Strengthened against the Background of a Subdued Income Outlook

According to the fall economic outlook of the OeNB, real income growth will be a mere 0.9% in 2004. In the first half of 2004, households strongly increased their financial investment in a year-on-year comparison; it reached about EUR 9.5 billion (chart 19). This fact reflects the ongoing uncertainty as to how the economy and income will develop.

In addition, there were structural changes in the composition of financial investment. While 2002 and the first half of 2003 saw a strong demand for liquidity in conjunction with a decline in tradeable investment, in

2004 all investment forms with the exception of cash holdings and deposits experienced a rise over the previous year. This shows, among other things, the increasing importance of the second and third pillars of pension provision. Moreover, owing to the steady increase in foreign currency loans, so-called repayment vehicles continue to be used.

After the striking valuation losses suffered in 2001 and 2002, households' financial assets had shown valuation gains amounting to EUR 2.4 billion as early as in 2003. In the first half of 2004, this trend continued with valuation gains of EUR 1.7 billion. Shares and mutual fund shares contributed to these increases. By contrast, the changes in the valuation of

Chart 19

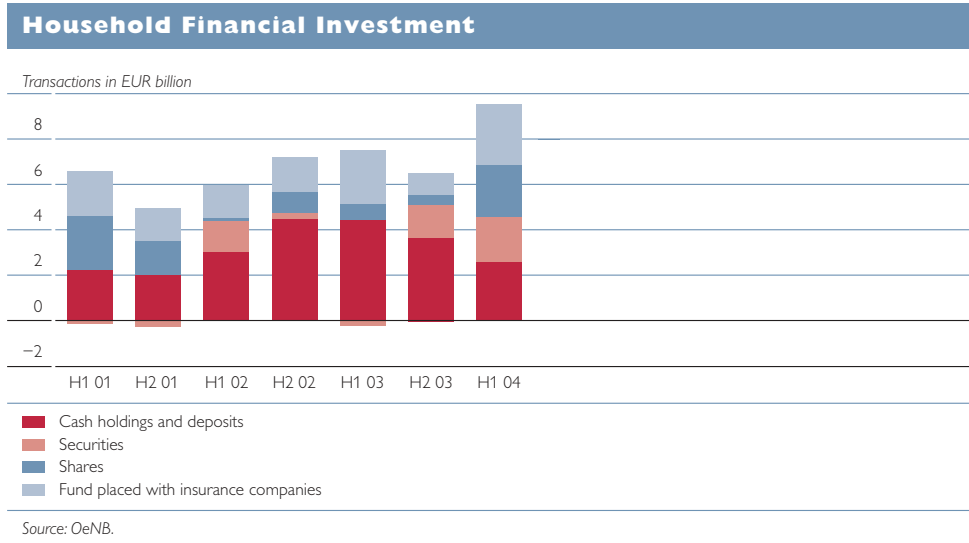
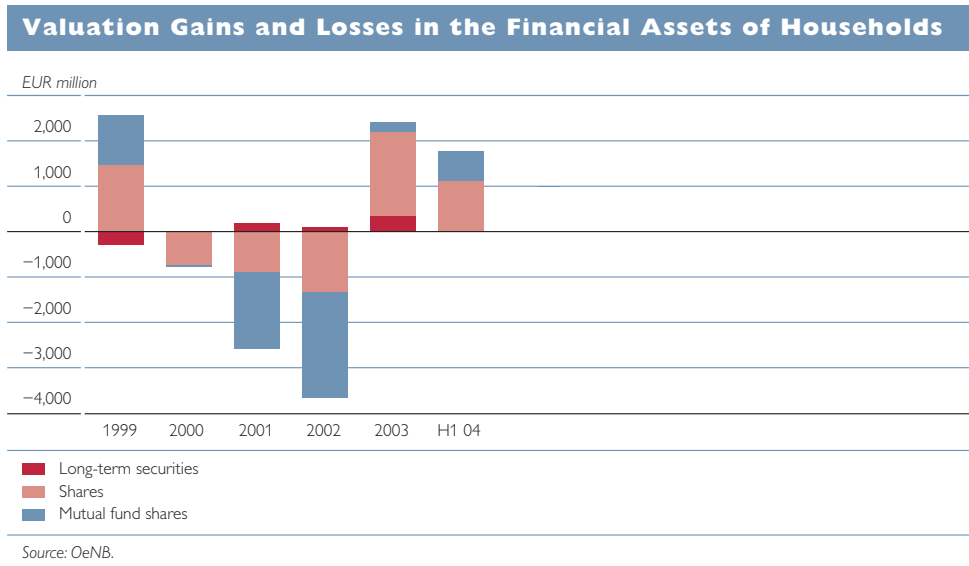


Chart 20



securities showed a slightly negative trend with a decline of EUR 16 million. If the trend of the first half of 2004 continues in the second half of the year, the valuation losses of 2001 and 2002 might be compensated for at the end of the year (chart 20).

#### Increase in Borrowing and Debt

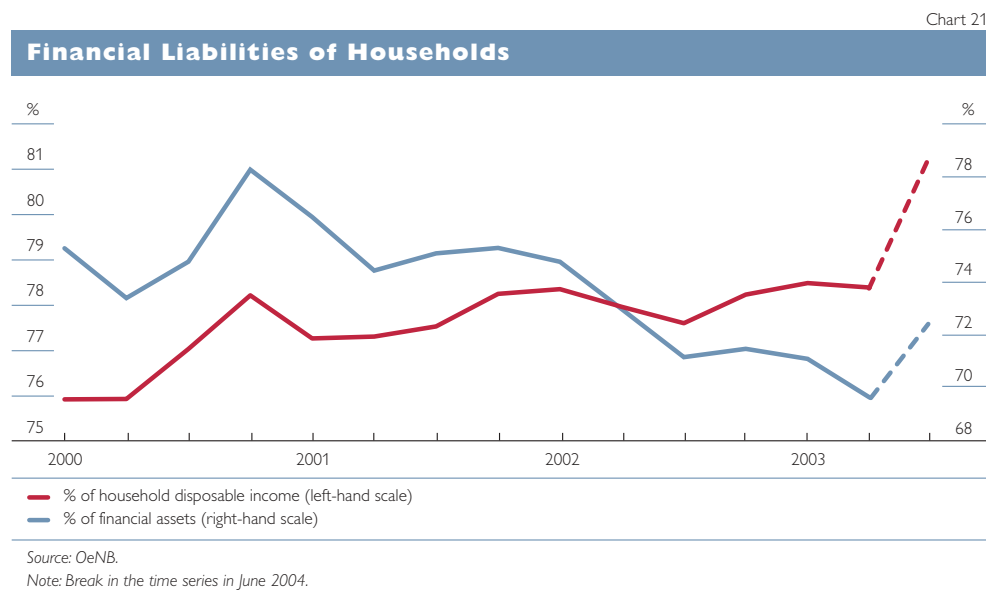
Increase in Lending to Households Accompanies More Relaxed Financing Conditions Households' borrowing volume came to EUR 3.6 billion in the first half of 2004, which is an increase of EUR 1 billion compared with the first half of 2003.<sup>47</sup> This rise was noticed espe-

<sup>47</sup> The growth of loans to households is distorted upwards to a certain extent, as foreign currency loans are often granted with a single, fixed maturity date. Please see the comment in the section "Banks" in the chapter "Financial Intermediaries in Austria."



cially in the second quarter. It has to be considered, however, that as of the reporting date of June 2004 considerable data revisions took place, which assume a volume of about EUR 1 billion and therefore make it difficult to interpret loan developments over time. An analysis of the first quarter of 2004 alone shows that borrowing declined from EUR 1 billion (2003) to EUR 0.8 billion. In the first half of 2004, household debt rose considerably in relation to the disposable income of households,

which reflects the extremely moderate development of household incomes. After the trend had reversed for more than two years, liabilities have again risen lately compared to the financial assets of households. They have not reached the levels of 2001 and 2002 though. However, by international standards, Austrian household debt measured in GDP is still low and was below the EU-15 average in 2002 (more recent data are not available).



Interest rates for loans to households remained at a low level. At the same time, the Austrian results of the Bank Lending Survey suggest that the financing conditions for households have been slightly relaxed.

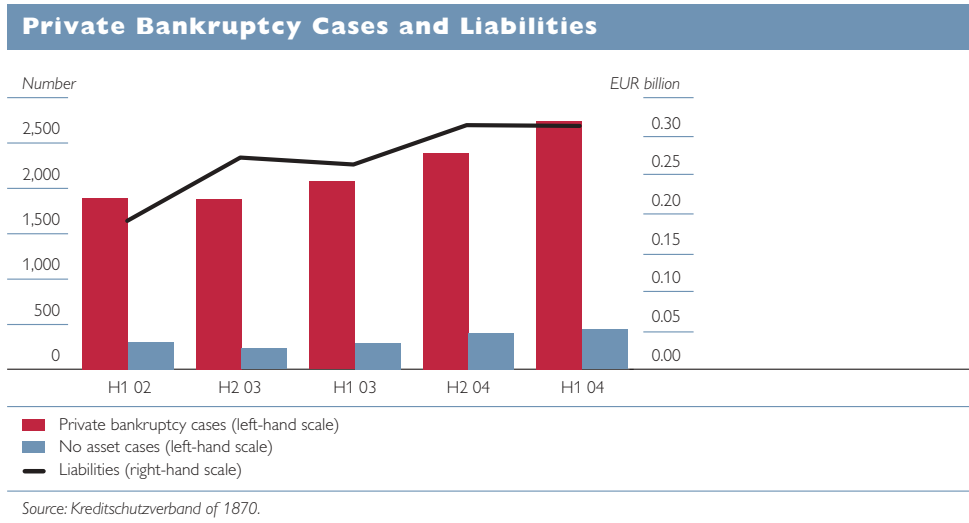
In parallel to the increase in household debt, the number of private bankruptcy cases rose in the first half of 2004. For this period, the KSV reported 2,379 debt regulation proceedings, i.e. private bankruptcies, which is an increase of 28.9% in a year-on-year comparison, as well as estimated default liabilities of EUR

0.31 billion (+19%) (chart 22). Not only the number of bankruptcy proceedings (and no asset cases) but also the amount of estimated liabilities rose in 2002 and 2003.

#### **Trend toward Higher Home Loans**

What did households take out loans for? Data from the financial accounts statistics show that home loans continued to post the highest share of new business in the first half of 2004 with a volume of EUR 2.2 billion. The Austrian results of the Bank Lending Survey also indicate that the banks

Chart 22



mainly considered the prospects of the housing market to be the decisive factor for the credit demand of households.

#### Moderate Rental Housing Cost Burden for Households

On the one hand, price trends on the real estate markets affect households' consumption and investment decisions via wealth effects.<sup>48</sup> On the other hand, real estate transactions are often financed through loans. Even if the HICP does not include housing prices, strong fluctuations can still have an effect on its subcomponents.<sup>49</sup>

The demand for residential real estate will continue to rise owing to a number of factors: the increasing level of mobility, the growing trend toward one-person households, young adults' personal wishes to have bigger and better homes as well as growing internationalization. The domestic construction industry met this demand and expanded by 1.7% follow-

ing the rise in construction orders for infrastructure and residential construction projects in 2003. The growth rate for 2004 to 2006 is estimated at 2% a year. In 2002, however, the number of housing completions fell owing to a reduced number of building permits granted in the previous years (–8.6% after –14.7% in 2001, both figures compared to the same period of the previous year).

The cost of home ownership continued to rise slightly, while property rental cost (2003: 42.9% of dwellings) sank (chart 23). This might be the result of both the stronger increase of operating expenses for homeowners, which is not limited under any rent law, and the increasing shortage in the housing market.<sup>50</sup> 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.

<sup>48</sup> Real estate is not just one of the most important types of assets, it is also collateral. Consequently, price fluctuations have a strong impact on households' propensity to take out loans and to invest.

<sup>49</sup> In particular, they may have an impact on the rental cost component of the HICP.

<sup>50</sup> However, this is only a conjecture, as the sample is relatively small.

Chart 23

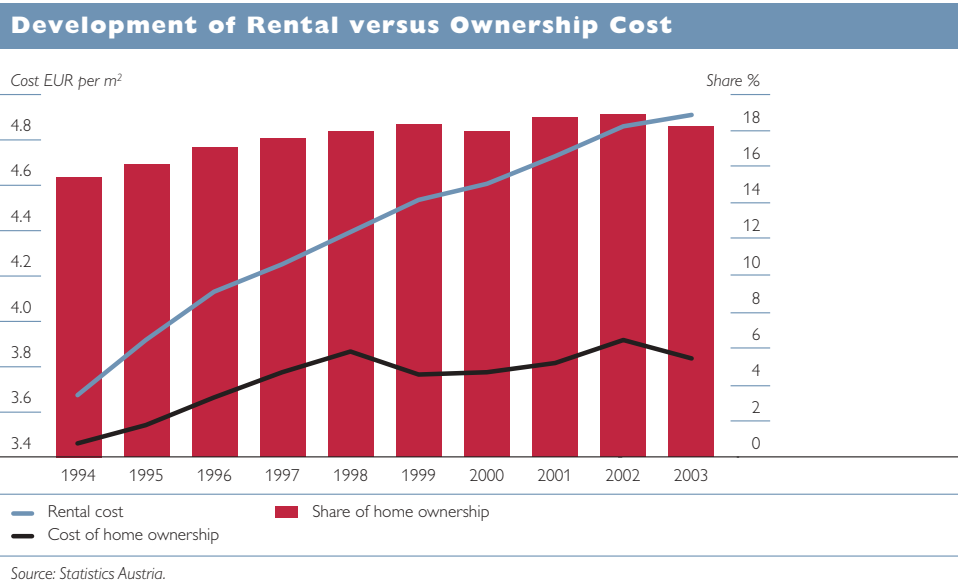
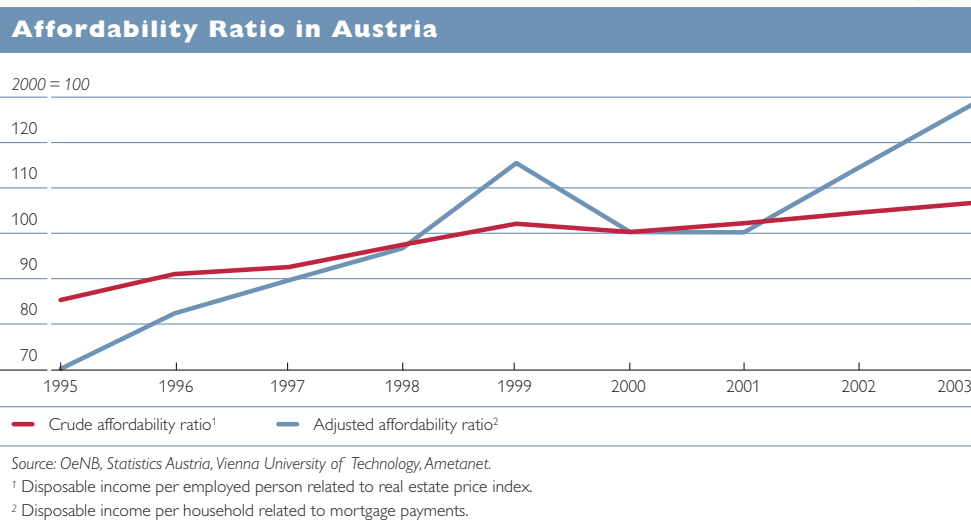


Chart 24



#### Rising Affordability Ratio Makes Real Estate Purchases More Affordable

The development of the affordability ratio shows that home ownership has become more affordable. For this ratio, households' disposable income, which is one of the major factors influencing the demand for real estate, is related to the real estate price

index. This crude affordability ratio has grown moderately since 1995. If the effects of low interest rates are taken into account, the adjusted affordability ratio (disposable household income related to the expenses for home loans)<sup>51</sup> shows that affordability has gone up more significantly since 2000 (chart 24).

<sup>51</sup> The annual payments of land acquisition tax and insurance are also considered. A calculation approach similar to that of the U.S. National Association of Realtors was used. Chosen assumptions: 80% of the selling price of an average owner-occupied dwelling is loan-financed, the average household income develops simultaneously to the disposable income per employed person, and the price development of the underlying owner-occupied dwelling is simultaneous to that of real estate prices.

### Financial Education in Austria

Financial institutions, central banks and supervisory authorities have put special emphasis on educational measures to improve citizens' insufficient capability to tackle ever more complex financial issues. The OECD recently initiated a project to study the current level of measures for enhancing financial literacy in its member countries.

Economic policymakers have pressed for legislation (especially in the field of pensions) that has initiated a change from state support to more individual saving for retirement. This shift of securing against risks into the private sector requires more personal responsibility. Can people meet these demands for more responsibility?

General financial education imparts the knowledge of how to make sensible use of financial services. Its objectives range from the prevention of crises and the promotion of the capital market to the prevention of poverty. The economic policy significance of this topic is underscored by issues such as exclusion, i.e. the phenomenon that not everybody has access to financial services, as well as the particular risks for the lower income strata.

Compared to the situation in the U.S.A. and the United Kingdom, no attempts to introduce a broad financial general education have been made in Austria. However, there is a host of initiatives in Austria as well. The Austrian Federal Economic Chamber, for example, with the help of the Federal Ministry for Education, Science and Culture, has developed a multi-year educational program for students between the age of 10 and 19. Basic economic knowledge is taught under the name "Unternehmerführerschein" ("European Business Driving License"). In the school year 2003/04, 1,500 Austrian students already took part in this project. Regional educational programs and the voluntary cooperation of businesses and educational institutions in the form of "educational clusters" will aim at intensifying the collaboration between industry and schools. Nonprofit organizations such as debt counseling services have been reacting to the problems of insolvent households by putting an increased focus on preventive measures. The OeNB has also tried to take preventive action by promoting individual and systemic financial stability with its publications.

### Development of the Financial Position of Nonfinancial Corporations and Households in the First Half of 2004

Banks continued to play a less significant role in financing and primary investment decisions of Austrian households and nonfinancial corporations in the first half of 2004. Corporate borrowing on the capital market (including unquoted shares) virtually equaled the entire external financing of corporations in this period, although banks have relaxed their lending policies somewhat. At the same time, three quarters of the growth of households' financial assets originated from (primary and nonintermediated) investments in the capital market (a consid-

erable share of which, however, was due to valuation gains). Thus, the real economy sectors' exposure to market risks has risen further.

The financial stability of the corporate sector increased in light of improved capital adequacy, higher profits and still relatively favorable financing conditions. Larger corporations both have and use a broad range of sources of financing. Consequently, the sources of funds are exposed to higher market risks, which is offset, however, by the corporations' continued high level of internal financing.

By contrast, the financial position of households became slightly more fragile despite the increase in the net lending, as in 2004, for the second time in a row, real income grew only

slightly and exchange losses on foreign currency loans were offset by valuation gains on market investment instruments. Although by and large, total household debt grew somewhat faster than household income in 2004, financial assets rose even more owing to a high saving ratio.