Working Party on Financial Statistics

INTERNAL FINANCING, CREDIT FLOWS AND ISSUANCE OF SECURITIES OF AUSTRIAN NFC
ACTING AS NET LENDER

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The paper has been prepared by Daniel Schmid, Karl Schwarz, Jürgen Weissenbacher (Statistics Austria, Sector Accounts and Public Finance Division) and by Michael Andreasch, Nicole Schnabl, Gerald Wimmer (Oesterreichische Nationalbank, External Statistics, Financial accounts and Monetary and Financial Statistics) and will be presented under item B.4 of the draft agenda

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Abstract

The paper focusses on the proportion of internal financing to external financing in the first part of the paper a) showing the composition both of internal and external financing in the last ten years, b) highlighting the importance of operating surplus and the stable development after the financial crises as well as the growing importance of securities issues on the contrary of the smoothing growth rate of credit financings. In the second part the use of the funds both for real investment as well as for financial investment, especially the role of so called portfolio investment (mainly as cash puffer), will be elaborated. Bridging both resources and use shows that the NFC sector as a whole was net lender in the last three years. The paper has been jointly prepared by members of the NSI and the central bank.

1. Financing of Nonfinancial Corporations

Saving, a key component of nonfinancial corporations' internal funding, equals retained earnings and is deduced from the operating surplus minus net investment income and income and property taxes paid. Apart from the capital transfer to ÖBB in 2004, corporates' net wealth developed more or less steadily up to 2009. Irrespective of the financial crisis, internal funding did not let up in 2009 (while investments posted negative growth rates), as operating surpluses contracted owing to increased net investment income.

In the last ten years nonfinancial corporations posted relatively stable savings and net capital transfers received (altogether recorded in the national accounts as net changes in net worth due to saving and capital transfer ) of an average 9% of gross value added. Incoming data indicate that, at 13.5%, internal funding in 2011 was clearly above the longer-term average due to net changes in net worth due to saving and capital transfer and thus also above external funding.

The profit share on a gross basis (defined as the gross operating surplus in relation to the gross value added by nonfinancial corporations) totaled 41% in 2011 at the same as in 2010. The profit share ranged between 39.5 (in 2009) and 43.7 (in 2007) in the past ten years. The internal financing on a gross basis as percentage of the sum of real and financial investment (other than direct investment of SPEs) amounted to 73.8% in 2011, compared to 73.7 % in 2010.

Despite the recent intensification of investment activity, the corporate sector recorded a financing surplus. This positive financing balance has been in place since 2009.

1 Cutoff date for data: May 2012; The paper has been prepared by Daniel Schmid, Karl Schwarz, Jürgen Weissenbacher (Statistics Austria, Sector Accounts and Public Finance Division) and by Michael Andreasch, Nicole Schnabl, Gerald Wimmer (Oesterreichische Nationalbank, External Statistics, Financial accounts and Monetary and Financial Statistics).

2 The 2004 data include the government's capital transfers to the Austrian Federal Railways ÖBB and thus show an extraordinary value under capital transfers received, which had drastically influenced the overall result.
External funding\(^3\) came to EUR 15.3 billion in 2011 compared with EUR 25.7 billion in 2010 (excluding the sharp declines in inward foreign direct investment by SPEs in 2010). In 2011, about half of businesses’ funding was ascribable to loans, and debt securities played an even greater role than in 2010. At some EUR 6.2 billion, newly issued debt markedly exceeded loans (EUR 1.6 billion) in 2011. Furthermore, equity financing accounted for 42% of external funding. An analysis of the past ten years reveals that loans and equity financing (excluding cross-border direct investments by domestic SPEs) each accounted for less than 40% of external funding. About half of the loans were extended by domestic banks. Foreign investors clearly dominated equity financing.

A major source of external funds was securities issuance in the last two years. Austrian corporates are eager to tap the bond market to take advantage of favorable borrowing conditions. In 2012, Austrian companies have raised more than EUR 4 billion (gross) of capital on the bond market in the first six months (excluding redemptions). Both predominantly government-owned enterprises and privately owned companies are increasingly turning to bonds as an interesting financing alternative to taking out loans. The bulk of Austria’s bonds are held by foreign investors. As International investors seeking to buy bonds distinguish very clearly between the different countries of the euro area this environment has a positive impact not just on the refinancing cost of the Austrian government but also on those of nonfinancial corporations, which carried yields averaging only 3.69% in the first half of 2012 (2011: 4.51%). Even privately owned companies, which are at a creditworthiness disadvantage compared to partially government-owned issuers, were able to sell bonds with a maturity of five to ten years at a yield of 4.16%, down by nearly one-quarter from 2011 (5.39%). Domestic companies took advantage of the favorable financing conditions to raise about EUR 4.5 billion of new capital (gross). In a nutshell, bonds have become attractive as a low-cost alternative to loans. According to the OeNB’s interest rate statistics, long-term major loans are currently still available at low interest rates of just under 3%, but such loans are given only to borrowers who provide extensive collateral. In the case of syndicated loans, financing also has long lead times and is thus less flexible. The lively issuing activity of private nonfinancial corporations now underway in Austria is noteworthy, as previously bond issues were typically a financing avenue for

\(^3\) Including the increase in equity through transactions.
predominantly government-owned companies. Foreign investors have purchased the bulk of bonds issued by Austrian corporates. However, the share of foreign ownership depends on the size of the issuing company and the related need for funds: The larger the issuing company and its need for funds, the larger the share of bonds held by foreign investors. As a rule, partially government-owned companies launch larger issues that they can currently place only with foreign investors. Accordingly, international bondholders account for more than 80% of investors in this corporate segment. The remaining bonds are held by Austrian banks (roughly 6%) and insurance companies, pension funds and mutual funds (10%). In contrast, the share of Austrian holders of bonds issued by Austrian private companies is markedly higher, with international investors owning only 43% of bonds in this segment. As private companies frequently turn to domestic banks as underwriters, and as their bonds are predominantly targeted at Austrian investors, Austrian banks (20%) and households (14%) hold a considerably higher share of Austrian private companies’ bonds than of government-owned companies’ bonds.

Comparing internal and external financing, the internal funding⁴ amounted to 7% of GDP in 2011, which is two percentage points above the external financing. In the past ten years the internal financing was 5% on average, while external financing amounted on average to 7% (excluding SPE financing activities offset by financial investment at the same amount). Overall, corporations’ financing has thus been firmly based on two equivalent pillars.

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⁴ In the sequence accounts, internal financing is referred to as the change in net worth due to saving and capital transfers. In the case of nonfinancial corporations, internal financing essentially results from retained earnings and depreciation; in the case of households from the difference between disposable income and consumption expenditure.
The liabilities of the nonfinancial corporations totaled EUR 693 billion at the end of 2011, or 231% of GDP (excluding liabilities of domestic SPEs: 206% of GDP). The claims of the domestic financial sector against the corporations amounted to EUR 190 billion (27%) at the end of 2011, which corresponds to about 63% of GDP. The lion’s share of those claims was in the books of domestic banks. In the past ten years, domestic banks had consistently accounted for some 92% on average of the financial sector’s assets vis-à-vis the nonfinancial corporations.

As the world has become increasingly globalized and as securities issuance has gained in importance in corporate debt financing, the share of nonresident creditors has increased as well. At the end of 2011 the claims of foreign investors totaled roughly EUR 280 billion representing 40% of the total liabilities. With a net international liability position within a range of 8% and 25% of GDP the corporate sector remained a net borrower from the rest of the world in the past ten years. The strong gross expansion of assets and liabilities vis-à-vis the rest of the world mainly as a result of cross-border direct investment activities was virtually symmetrical under the impact of globalization, which is why the net position results above all from cross-border portfolio investment as well as cross-border bank loans. In 2011 the corporate sector had net liabilities of about 13% of GDP (EUR 40 billion) vis-à-vis the rest of the world.

2. Investment by Nonfinancial Corporations

Real investment primarily comprises gross fixed capital formation next to inventory changes and acquisitions less disposals of valuables. Nonfinancial corporations mainly invest in four types of gross fixed capital formation: Construction, machinery, metal products, transport equipment and other products.

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5 The reporting year 2005 saw the creation of the first special purpose entities (SPEs) in Austria whose foreign direct investment activities affect both the equity position on the asset and the liability side of firms’ balance sheets.
Gross capital formation was driven by investments in metal products and machinery on the one hand and highly volatile inventory changes on the other. In the past two years, inventory changes likewise accounted for about half of the growth. For the second time, nonfinancial corporations markedly stepped up real investment (equaling 32% of the corporate sector’s gross value added) in 2011 after the corresponding 2010 figure had amounted to 29%. Over the past ten years, this share came to around 30% on balance. Since replacement investment remained constant relative to value added, net capital formation likewise rose over the previous two years. The corporate sector invested around 12% of its value added in 2011, which was significantly more than in 2009 and 2010. Net capital formation amounted to some 10% on average over the long term.

At the same time, the nonfinancial corporations also made financial investments. To increase comparability with real investment, financial investment was adjusted for special factors. Adjusted financial investments ran to some 12% of the corporate sector’s gross value added, based on financial accounts data. The analysis shows that adjusted financial investment and net real investment had developed within a similar bandwidth over the last decade. Both measures each held a share of around 10% of nonfinancial corporations’ gross value added. Yet, from 2005 onward, financial investment (even on an adjusted basis) was much more volatile than real investment. One has to bear in mind in this context that financial investment from loans or trade credits between domestic companies was factored in only from 2006. Financial investment therefore equals borrowing of the same worth, and both gross measures increased as a result.

To classify financial investment of nonfinancial corporations into traditional portfolio investment on the one hand and trade credits based on deliveries or services as well as strategic financial investment on the other, the financial accounts data were broken down into financing instruments and counterpart sectors.

Equity investments within the domestic corporate sector and with foreign companies accounted for 31% (long-term average for the period 2002–2011) of total financial investments. Loans among domestic companies (among affiliated companies and subsidiaries) and to foreign companies held a share of 15% in total financial investments. Financial investments by domestic SPEs from cross-border direct investments accounted for 30% of fixed capital formation during the observation period. This is quite striking given that these activities began on a larger scale only in 2005. Around 15% (with very high volatility year on year, though) were ascribable to portfolio investments. Based on adjusted financial investment, the share of portfolio investments increases to 24% on average for the period 2002 to 2011. Interestingly, portfolio investments became negative for the first time in 2011. In other words, companies reduced portfolio investments in net terms, particularly by selling mutual fund shares.

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6 Counterbalancing consumption of existing investments.

7 Such special factors include above all cross-border equity capital transactions of so-called domestic SPEs under direct investment (especially in 2005, 2007 and 2010) as well as the rerouting of liabilities of public corporations to the general government (made necessary through budgetary notification requirements). Put differently, these companies extended credit to the general government.

8 Accordingly, the change in cash holdings and deposits, the net acquisition of debt securities, listed shares of the financial sector as well as mutual fund shares was allocated to portfolio investments. Loans to domestic and foreign nonfinancial corporations, the acquisition of listed shares and other shares fall under strategic financial investments. The residual item comprises trade credits, the financial transactions of domestic SPEs under cross-border direct investments (from 2005 onward) as well as other net purchases of financial assets. Loans and trade credits among domestic companies are classified under financial accounts data as from the reporting year 2006.
A detailed analysis of portfolio investments reveals that nonfinancial corporations made such investments above all in times of economic recovery. Rising interest rates, especially on short-term assets, tend to foster heightened portfolio investment activity, which is concentrated primarily on deposits with short maturities. Such assets accounted for 85% of portfolio investments. Mutual fund shares played a role in financial investment only around the turn of the millennium, and long-term debt securities were on average hardly ever used as portfolio investments by businesses over the past ten years. As liquidity reserves, total portfolio investments were rather complementary to financial investment in the form of loans (including trade credits) and equity shares.

Portfolio investments amounted to EUR 75 billion at end-2011, equaling around one-fifth of nonfinancial corporations' financial assets (adjusted for special factors). Their volume therefore corresponded to loans outstanding to domestic and foreign companies. Short-term\(^9\) financial investment accounted for EUR 54 billion (or some 70%), with EUR 32 billion attributable to overnight deposits.

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\(^9\) Cash, deposits, money market paper and money market fund shares/units.