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FINANCIAL FLOWS AND BALANCE SHEETS OF HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS IN 2020

Víctor García-Vaquero and Juan Carlos Casado

ABSTRACT

The Financial Accounts of the Spanish Economy show that in 2020 the developments in balance sheets and financial transactions were strongly influenced by the health, social and economic crisis and by the extraordinary economic (monetary, fiscal and financial) policy measures adopted to mitigate its effects. Against this background, unlike the previous three years, households reduced their debt in the form of bank loans, essentially owing to the sharp slowdown in consumer credit. However, given the more pronounced contraction in household income, their aggregate debt/gross disposable income (GDI) ratio rose by 2.1 percentage points (pp) to 94.8%, breaking the downward trend of the previous years. The debt-to-GDP ratio of non-financial corporations also increased (by 12.3 pp to 85%), which is explained not only by the decline in GDP but also by the considerable growth in new financing, primarily in the form of bank loans. A further relevant aspect in 2020 was the substantial rise in holdings of liquid assets by firms and households since firms built up precautionary liquidity buffers and households sharply increased their saving.

Keywords: financing, credit, investment in financial assets, household debt, non-financial corporations and saving rate.

JEL classification: D22, G21, L25, M21, R2.

FINANCIAL FLOWS AND BALANCE SHEETS OF HOUSEHOLDS AND NON-FINANCIAL CORPORATIONS IN 2020

The authors of this article are Víctor García-Vaquero and Juan Carlos Casado of the Directorate General Economics, Statistics and Research.

Introduction

This article analyses the changes in the balance sheets and financial transactions of households and non-financial corporations (NFCs or firms) in 2020, drawing on information from the Financial Accounts of the Spanish Economy (FASE).[1] These changes took place in an environment influenced, first, by the health, social and economic crisis, which prompted the Spanish economy's GDP to contract by 10.8% in 2020, and, second, by the extraordinary economic (monetary, fiscal and financial) policy measures geared towards lessening the impact of the crisis. Monetary conditions were characterised by interest rates holding at very low levels, while in the financial markets the most prominent aspect was the sharp drop in the valuations of risk-bearing assets at the onset of the pandemic. This movement subsequently tended to reverse, supported initially by the actions of the various economic authorities and later by the announcement of effective vaccines against COVID-19.

The FASE show that the financial position of households and NFCs weakened in 2020. The debt ratios of both segments rose, breaking the trend of recent years. In the case of households, the debt/gross disposable income (GDI) ratio climbed by 2.1 pp to 94.8%, owing to a smaller decline in the numerator than in the denominator. In the case of firms, interest-bearing borrowing grew by 12.3 pp in 2020 to stand at 85% of GDP, driven by both the increase in debt and, to a greater extent, the contraction of GDP. In parallel, unlike the previous year, household gross financial wealth declined. This was despite the fact that their net investment in financial assets was positive (fuelled by the extraordinary increase in the saving rate), since falling equity prices prompted a sharp drop in the value of their financial portfolio.

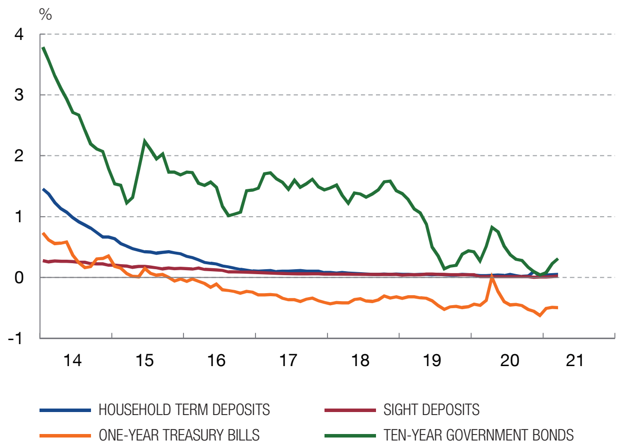
The renewed preference for more liquid assets caused households to invest primarily in bank deposits and cash, followed by collective investment instruments, particularly investment fund shares or units. Likewise, firms concentrated their financial investment in cash and deposits, with a preference for current accounts and, to a lesser extent, shares and other equity.

1 More detailed information on the FASE can be viewed at this link: https://www.bde.es/webbde/en/estadis/infoest/temas/te_cf.html.

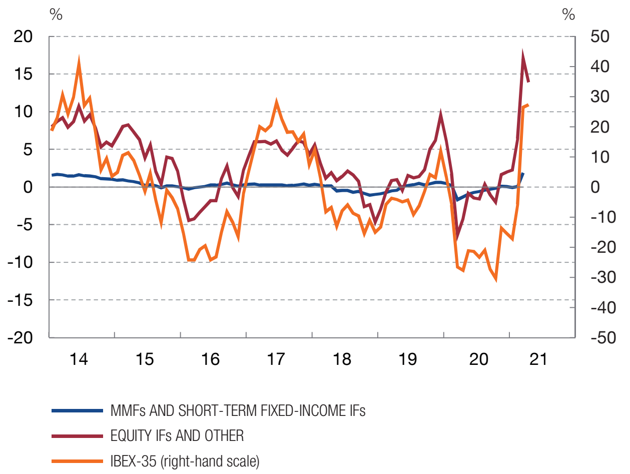
Chart 1
INTEREST RATES HELD AT LOW LEVELS, WHILE THE PANDEMIC HAD A NEGATIVE IMPACT ON EQUITY PRICES

Interest rates on short-term saving products, such as bank deposits and Treasury bills, stood at near-zero or negative levels, while long-term Spanish government bond yields continued on a downward trend, reaching a zero rate of return at end-2020. Equity prices declined sharply at the onset of the pandemic and subsequently tended to reverse.

1 INTEREST RATES



2 RETURNS ON IBEX-35 AND INVESTMENT FUNDS (a)



SOURCES: INVERCO and Banco de España.

a 12-month cumulative return.

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Following this introduction, this article comprises two sections. The first section describes the changes in the financial flows and balance sheets of households in 2020 and the second includes a similar analysis for non-financial corporations.

Household financial flows and balance sheets

Financial flows

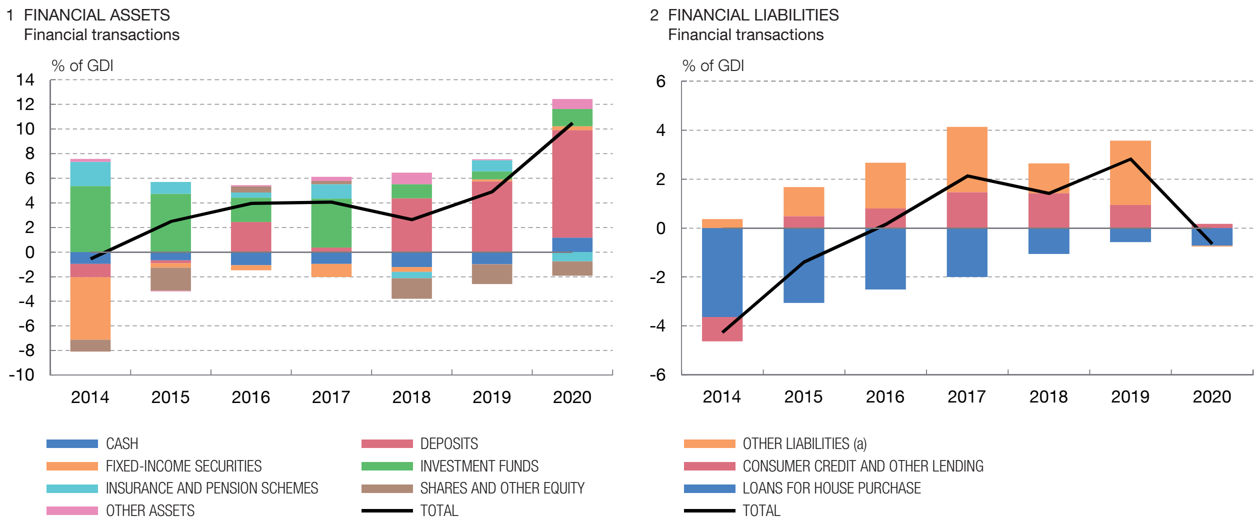
The household gross saving rate rose sharply in 2020 to stand at 14.8% of GDI (6.3% in 2019), representing the highest saving rate of the last 40 years. This change was attributable to the strong decline in spending, linked to both the climate of heightened uncertainty and, in some cases, to barriers to spending owing to restrictions on movement and the closure of certain activities, along with the relative resilience of income on account of the public support measures.[2] As in the previous year, monetary and financial conditions were again marked by very low interest rates. As Chart 1.1 shows, both bank deposits and, to a greater extent, Treasury bills recorded near-zero

2 For a more detailed analysis, see J. A. Cuenca, C. Martínez Carrascal and A. del Río (2021), "Household saving during the pandemic and its possible effects on the future recovery in consumption", Box 4 of the "Quarterly report on the Spanish economy", *Economic Bulletin,* 1/2021. Banco de España.

Chart 2

IN 2020, HOUSEHOLDS' NET ACQUISITION OF FINANCIAL ASSETS CONTINUED THE DOWNWARD TREND OF PREVIOUS YEARS, WHILE LIABILITIES WERE CANCELLED IN NET TERMS

Household investments took the form of bank deposits. As regards liabilities, household debts in the form of bank loans decreased for the first time in three years.



SOURCES: INE and Banco de España.

a Including statistical adjustments.

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or negative interest rates, while long-term Spanish government bond yields remained on a downward trend, reaching a zero rate of return at end-2020, although they picked up in the early months of 2021. As can be seen in Chart 1.2, stock prices plummeted at the onset of the pandemic, a movement that subsequently tended to reverse. In keeping with this performance, investment funds investing in these assets posted negative year-on-year returns during the spring months, which later gradually moderated.

Against this background, households' net acquisition of financial assets increased significantly as compared with previous years, rising to 10.5% of their GDI from 4.9% in 2019 (see Chart 2.1).

One of the most striking aspects of households' financial asset flows was the renewed preference for more liquid assets. This may be linked to both the climate of financial market tension in the first part of the year and to the relatively temporary nature of a considerable portion of the new saving generated on account of the barriers to certain spending. Thus, over the course of 2020 households' new financial investments were largely concentrated in deposits (8.7% of their GDI) and in cash (1.2% of their GDI). The shift in trend in cash held by households should be noted, presenting positive growth figures for the first time in 12 years. Net purchases of investment fund shares or units and of fixed-income securities stood at 1.4% of their GDI and 0.6% of their GDI, respectively, in both cases above the 2019 figures.

Net investment in shares and other equity was negative for the third consecutive year (-1.2% of their GDI), as was net investment in insurance and pension schemes (-0.8% of their GDI).

As regards borrowing, in contrast with the increases of the two previous years, households moderately reduced their debt in the form of bank loans (-0.6% of GDI; see Chart 2.2). By component, this change was determined basically by the sharp slowdown in consumer credit and lending other than for house purchase.[3]

The outstanding balance of financial assets and liabilities

Household gross financial wealth declined by 1.7% in 2020, compared with the increase of 5% in the previous year (see Chart 3.1). This happened despite growth in the acquisition of new assets, which was offset by the heavy fall in the value of their financial portfolio, and in particular in the value of share-linked instruments. This negative revaluation effect occurred both through direct holdings of equity and indirect holdings via investment and pension funds. GDI declined more sharply than the portfolio of financial assets, prompting the ratio of financial assets to GDI to rise by 5 pp to 317%.

The new investments and valuation changes resulted in significant shifts in the relative weight of the various assets constituting household gross wealth. A case in point is the sharp relative increase in bank deposits, up 3.4 pp to 39.7% of total assets (see Chart 3.2). For yet another year, this increase was concentrated in sight deposits (34.3% of the total, compared with 29.8% in 2019), while the share of term deposits declined from 6.6% in 2019 to 5.4% in 2020.

The weight of cash holdings rose by 0.4 pp, reaching 2.4% of total assets in 2020 and breaking the recent downward trend.

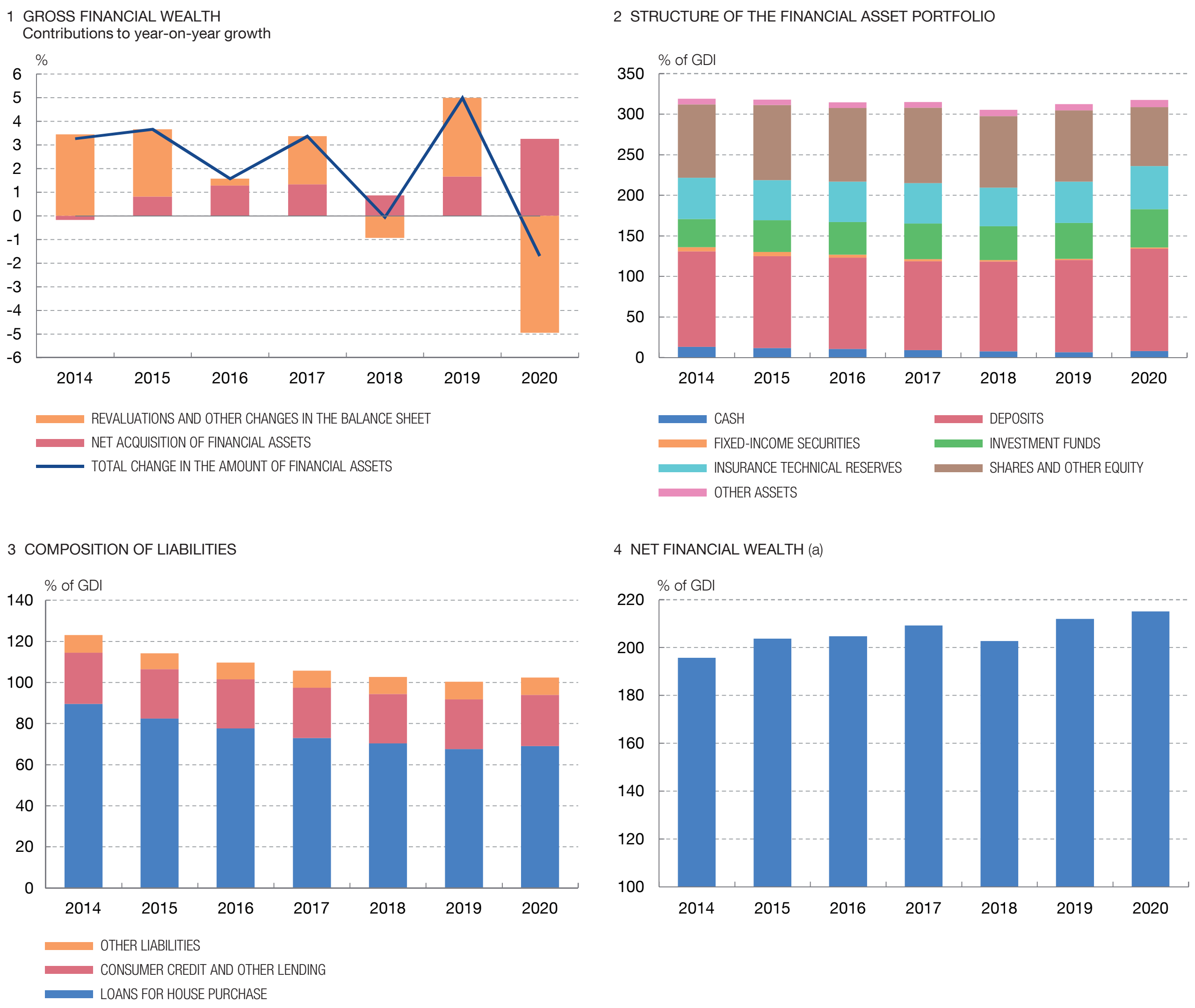
In addition, the institutionalisation of saving continued to the detriment of direct holdings. This took shape: (i) in a fresh increase in the relative importance of investment fund shares or units, which amounted to 14.8% of household total gross financial wealth, up 0.6 pp on 2019; and (ii) in a rise[4] in insurance technical reserves and pension funds, which represented 16.7% of total assets compared with 16.3% in the previous year. The weight of shares and other equity dropped sharply (-5.2 pp of the total) to 23.0% of the total and that of fixed-income security portfolios increased very slightly.

3 The information on this breakdown is not obtained from the FASE but from the Banco de España's monetary and financial statistics.

4 These movements are consistent with the decline in insurance and pension plan operations discussed in the section on flows, given the steeper fall in GDI.

Chart 3
HOUSEHOLDS' FINANCIAL ASSETS AND LIABILITIES, IN TERMS OF GROSS DISPOSABLE INCOME, ROSE SLIGHTLY IN 2020

The gross financial wealth of households decreased in 2020, since the acquisition of new assets was offset by the decline in the value of their financial portfolio. The share of cash and bank deposits in the household portfolio recorded a strong increase, as did holdings in collective investment instruments to the detriment of direct holdings in marketable securities. Household debt and net financial wealth decreased to a lesser extent than gross disposable income (GDI); accordingly, the ratio of these items to their GDI rose slightly.



SOURCES: INE and Banco de España.

a Difference between financial assets and liabilities.

Turning to liabilities, the household debt ratio[5] increased for the first time in the most recent period to 94.8% of household GDI, up 2.1 pp on 2019 (see Chart 3.3) since the value of debt declined more moderately than income, the latter being the denominator of this ratio.

5 The definition of debt used includes only liabilities in the form of bank loans.

By instrument, the relative share of the two components of bank debt grew in 2020. The outstanding balance of loans for house purchase climbed 1.4 pp to 69% of GDI, as did that of consumer credit and other lending, albeit less sharply (0.7 pp of GDI), which amounted to close to 24.9% of GDI. By contrast, the volume of other liabilities decreased slightly to 8.5% of GDI.

The balance of household financial assets increased more steeply, in terms of GDI, than their balance of liabilities, which prompted the sector's net financial wealth ratio to rise again, reaching 215% of GDI, its highest level since 2005 (see Chart 3.4).

Firms' financial flows and balance sheets

Financial flows

Unlike the case of households, the gross saving rate of firms dropped by 1.3 pp to 16.2% of GDP in 2020. Nevertheless, net investment by NFCs in financial assets was positive once again, amounting to 5.5% of GDP, which was higher than in 2019 (see Chart 4.1). The rise is largely attributable to certain firms increasing their borrowings to build up precautionary liquidity buffers.[6]

In line with these developments, the net acquisition of cash and deposits by NFCs amounted to 3.8% of GDP (mainly in the form of sight deposits), up 2.7 pp on the figure for 2019. Investment in equities and in fixed-income securities also increased, albeit to a lesser degree, by 0.9% and 0.5% of GDP, respectively, whereas loans to the rest of the world fell by 0.4% of GDP. Financing granted through trade credit contracted robustly, in line with the sharp decline in economic activity.[7]

As shown in Chart 4.2, net financing flows received by firms (both callable and non-callable funds) surged in 2020 to stand at 3.8% of GDP. By instrument, the flow of bank lending turned positive for the first time since 2016 and constituted the main source of financing, reaching 3.2% of GDP, spurred by firms' higher financing needs – to plug the liquidity shortfall triggered by the fall in activity – and by the public guarantee scheme.[8] Funds raised in the form of shares and other equity amounted to 1.5% of GDP, down 0.3 pp on the previous year's figure. These funds were obtained by issuing unlisted (0.8% of GDP) and listed (0.1% of GDP) shares, and through other equity (0.6% of GDP).

6 For further details, see Banco de España (2021), "The effects of the COVID-19 crisis on the productive sectors in Spain: economic and financial implications", Chapter 3, *Annual Report 2020.*

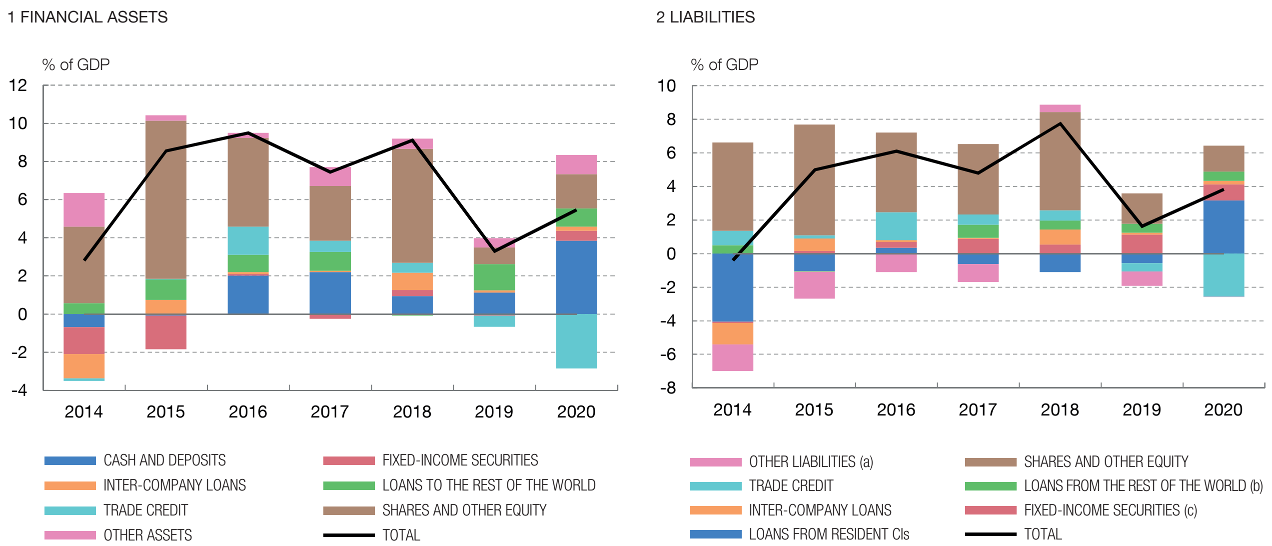
7 Trade credit stems from the deferral of commercial transactions. Thus, this item is tied very closely to economic activity: it grows during booms and shrinks during contractions.

8 For further details on the effects of this programme, see Banco de España (2021), "The effects of the COVID-19 crisis on the productive sectors in Spain: economic and financial implications", Chapter 3, *Annual Report 2020.*

Chart 4

FIRMS' INVESTMENT IN FINANCIAL ASSETS AND NET FINANCING WERE POSITIVE AGAIN IN 2020, FOR AMOUNTS HIGHER THAN IN 2019

Investment was concentrated in cash and bank deposits, while funding was mainly obtained through bank loans and, to a lesser extent, shares and other equity.



SOURCES: INE and Banco de España.

a Including statistical adjustments.
b Excluding trade credit.
c Including net issues of securities by resident subsidiaries of NFCs.

Net issues of fixed-income securities remained positive (1% of GDP, similar to the previous year) driven partly by the Eurosystem's corporate sector purchase programme, including corporate bond purchases as part of the new pandemic emergency purchase programme (PEPP).

Lastly, net financing through loans from the rest of the world was positive (0.6% of GDP), very similar to that recorded in previous years. Thus, in 2020 the flow of total external financing raised, in consolidated terms, by NFCs (resident bank credit, fixed-income securities and loans from the rest of the world) stood at 4.7% of GDP, a substantially higher figure than that recorded in 2019 (1.1% of GDP).

The outstanding balance of financial assets and liabilities

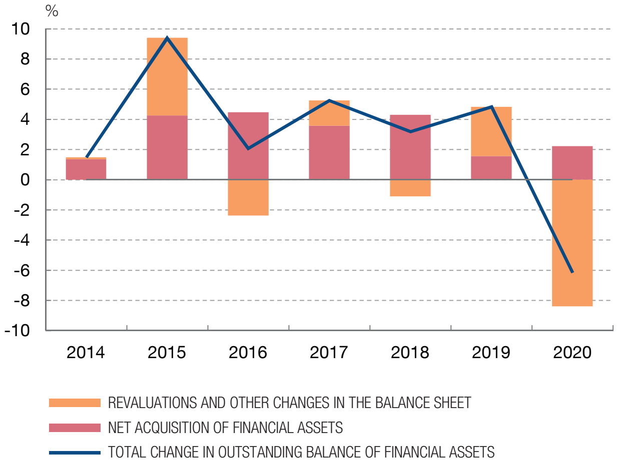
The outstanding balance of firms' financial assets posted a marked decline in 2020 (-6.2%, compared with growth of 4.8% in 2019), representing the first fall in assets since 2012. This was prompted by the drop in asset prices and other changes in volume, which offset the positive net investment in financial assets (see Chart 5.1).

Chart 5

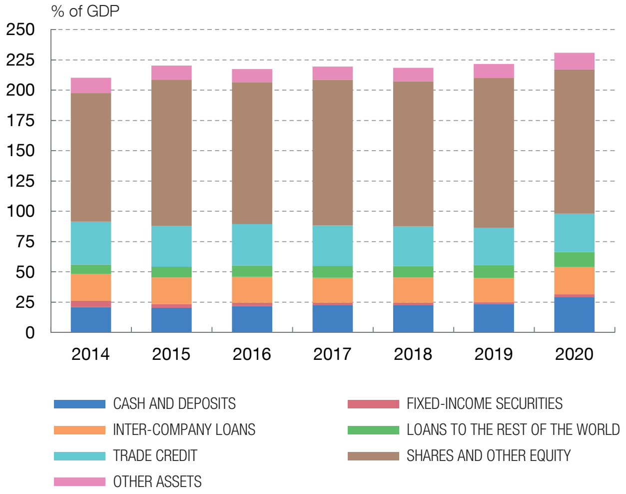
THE OUTSTANDING BALANCE OF FIRMS' FINANCIAL ASSETS, IN GDP TERMS, DECLINED IN 2020, WHILE THE DEBT-TO-GDP RATIO INCREASED, INTERRUPTING THE DOWNWARD TREND INITIATED IN 2010

Firms' investment in financial assests was offset by the decline in its value, which led to a fall in the corporate sector's gross financial assets. Firms' debt (claimable liabilities), in terms of GDP, increased for the first time in the last 11 years. The market value of own funds relative to GDP decreased.

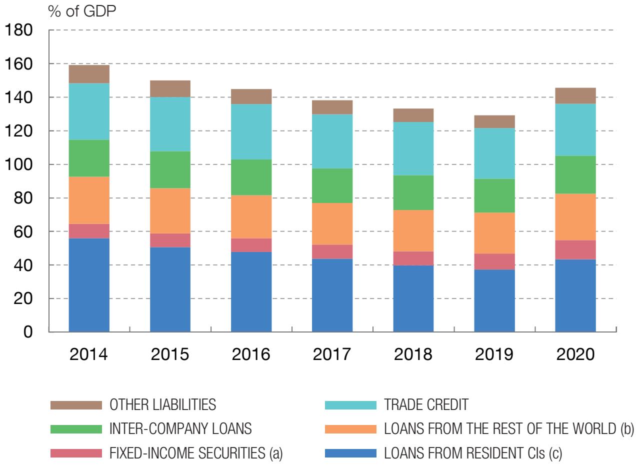
1 OUTSTANDING BALANCE OF FINANCIAL ASSETS
Contributions to year-on-year growth



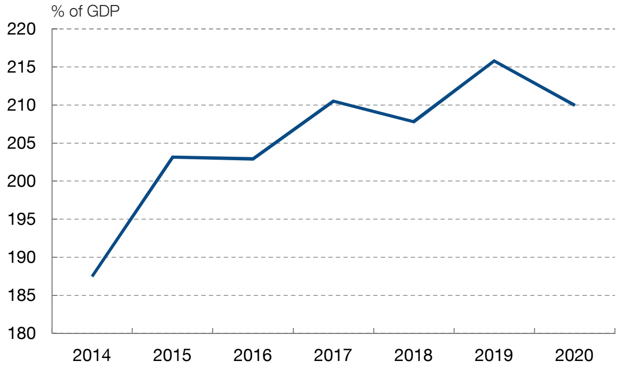
2 STRUCTURE OF THE FINANCIAL ASSET PORTFOLIO



3 CLAIMABLE LIABILITIES



4 OWN FUNDS



SOURCES: INE and Banco de España.

a Including securities issued by resident subsidiaries of NFCs
b Excluding trade credit.
c Including off-balance sheet securitised loans and loans transferred to Sareb.

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As a result of this decline in valuations and of the acquisition of new assets, the structure of NFCs' financial portfolio changed significantly compared with 2019 (see Chart 5.2). For instance, the weight of shares and other equity dropped sharply[9] (although they remain the portfolio's main component), standing at around 51.6% of the total (equal to 119% of GDP), with the particularity that unlisted equities continue to account for the bulk of this category (44.4% of the total of these assets). By contrast, the increases were manifest, first, in the proportion represented by cash and deposits, which climbed markedly to 12.7% of the total (equal to 29.3% of GDP) and, second, in the weight of loans to the rest of the world which rose to 5.4% of the total (accounting for 12.4% of GDP). The relative importance of trade credit granted also increased, standing at 31.5% of GDP (in keeping with the fall in the related flows, given the sharp decline in GDP), as did that of inter-company financing, albeit slightly more sharply (22.6% of GDP). Lastly, the proportion represented by the balances of fixed-income securities held at similar levels to those of the last four years, at around 1% (or 2% of GDP).

The volume of NFCs' non-consolidated claimable liabilities increased by 16.5 pp of GDP in 2020 to 146%, interrupting the protracted downward trend initiated in 2010 (see Chart 5.3). All the components of this variable posted increases in 2020. Thus, bank loans extended by resident banks rose to 43.3% of GDP. In addition, the two components which are traditionally a source of financing for large corporations increased: external loans amounted to 27.6% of GDP (up 3.2 pp on 2019) and securities other than shares totalled 11.5% of GDP (up 2.1 pp on the previous year), the largest figure since 2005. Lastly, inter-company financing and trade credit granted also posted increases to 22.6% and 30.9% of GDP, respectively. However, in the latter case, the rise is explained by the strong decline in GDP (the denominator), since the balance in euro of this item decreased.

As a result of these developments, the debt ratio (bank credit from resident institutions, external loans and fixed-income securities) climbed by 12.3 pp in 2020 to stand at 85% of GDP. This rise is due both to the increase in the numerator and, largely, to the decline in GDP.

Finally, the value of NFCs' own funds decreased by 12.3% since the funds tapped and the earnings retained were insufficient to offset the decline in the value of these instruments. This fall, which exceeded the decline in GDP, resulted in a decrease in the own funds/GDP ratio (which stood at 210% at end-2020 after shedding 6 pp).

17.6.2021.

9 This was the result of the increase in transactions with equity instruments and the sharper decrease in the prices of these assets.