



German Banks In 2024: Rating Resilience Despite Economic Underperformance

S&P Global
Ratings

Benjamin Heinrich

Heiko Verhaag

Harm Semder

Claudio Hantzsche

Lukas Freund

Richard Barnes

Karim Kroll

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This report does not constitute a rating action

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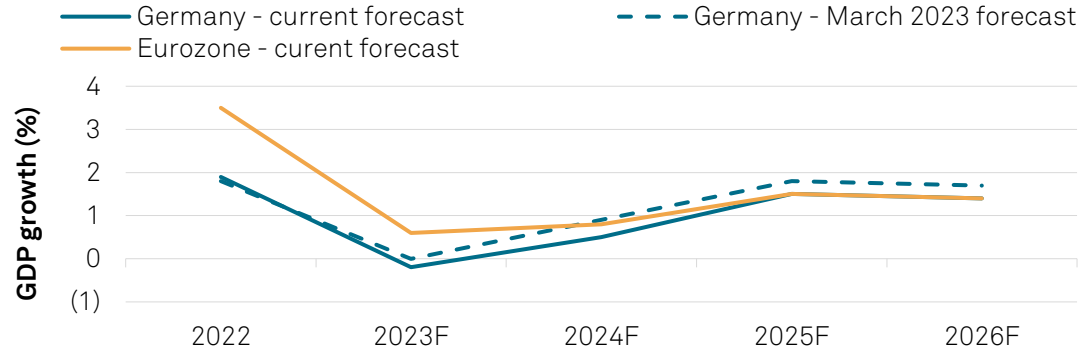
German Banks | Key Expectations

- **S&P Global Ratings forecasts German banks' consolidated earnings will improve slightly in 2024** but profitability will remain a relative weakness for the German banking sector. This is primarily due to inefficient cost bases, overcapacity, and intense competition.
- German banks benefited substantially from higher interest rates, but **we expect support from cyclical interest to peak in 2024**. The increase has been driven by improved liability margins rather than better asset margins, because credit demand remained subdued. We expect pressure on interest margins as funding costs rise slightly faster than the banks' average lending rates.
- **We anticipate a slight increase in credit losses from low levels**. We expect the household and corporate sectors will prove resilient despite a weak economic outlook. This stems from banks' overall prudent risk management, favorable employment rates, and the corporate sector's financial health and proven ability to adapt to challenges. We expect capital and liquidity buffers will remain solid.
- **Commercial real estate (CRE) is a pocket of risk for some German banks but not a systemic risk**. CRE loans often represent a small portion of the loan portfolio, with banks mainly acting as senior lenders and losses limited due to sufficient collateral. That said, our negative outlook on Deutsche Pfandbriefbank, a monoline CRE lender, reflects risk of materially increasing credit losses in deteriorating CRE markets, particularly in the U.S.
- **We expect Deutsche Bank and Commerzbank to deliver more consistent and predictable returns, thereby improving their resilience**. This was reflected with positive rating actions in 2023. We also think the German cooperative and savings banks sectors can recover gradually the large revaluation losses on long-dated, high-quality securities, which temporarily affected profits in 2022.
- **We think digital disruption risk has eased**. Banks have strongly invested in their digital skills, and we consider them able to meet client demands.
- **The outlooks on most banks remain stable, which makes rating changes unlikely over the next two years**. Despite this, pressure on ratings could result from a larger-than-expected deterioration in asset quality. Conversely, we could raise our ratings on German banks if the sector's structural profitability closes the gap to its European peers. Idiosyncratic developments could also lead to positive rating actions, such as from improved profitability, further build up of capital, or better diversification.

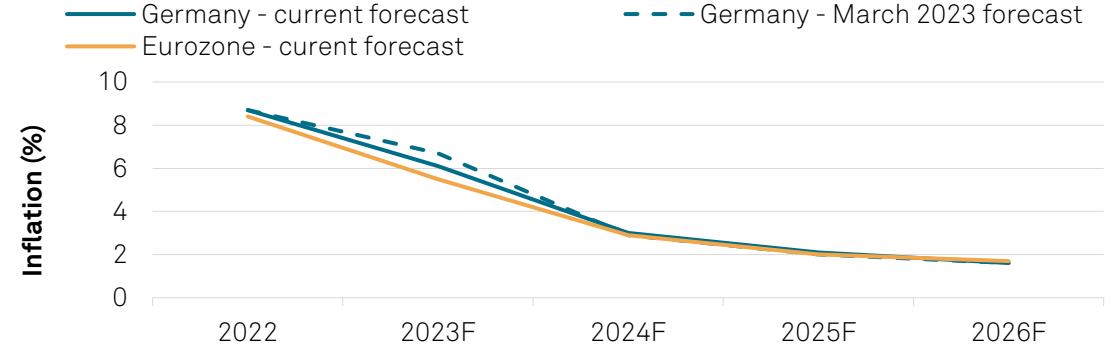
The Operating Environment Will Remain Challenging In 2024

But German labor market resilience is a key mitigant to higher credit losses

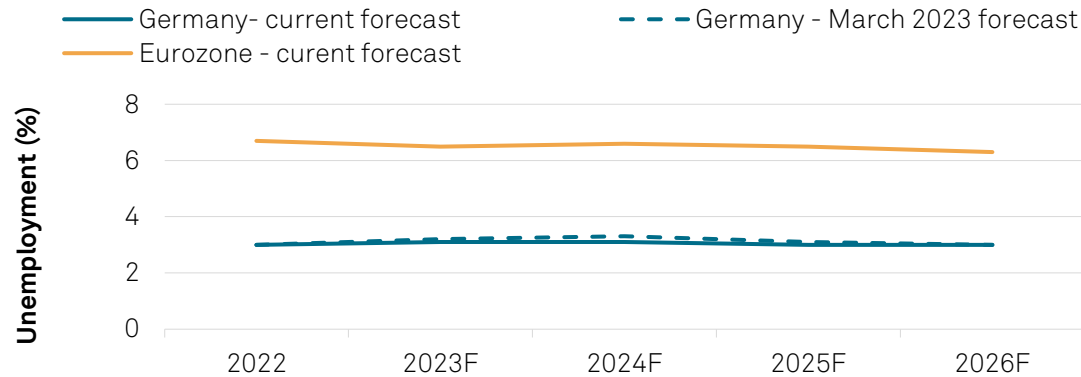
Germany will underperform until 2025



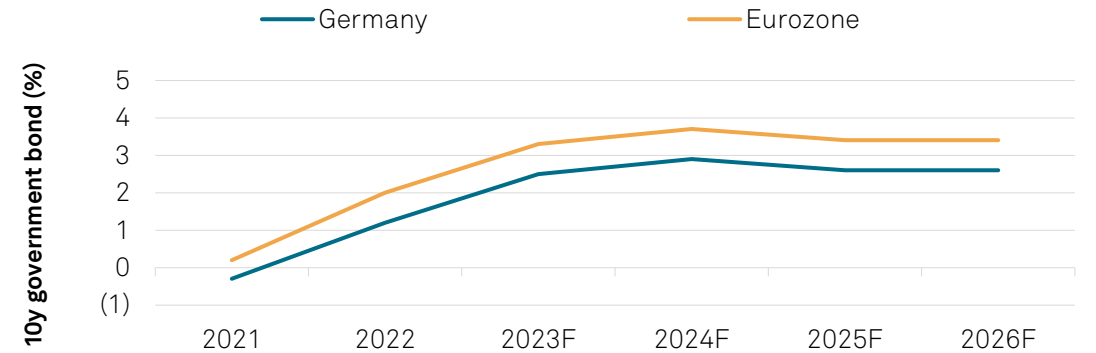
Inflation could fall to just 2% in 2025



The German labor market remains resilient



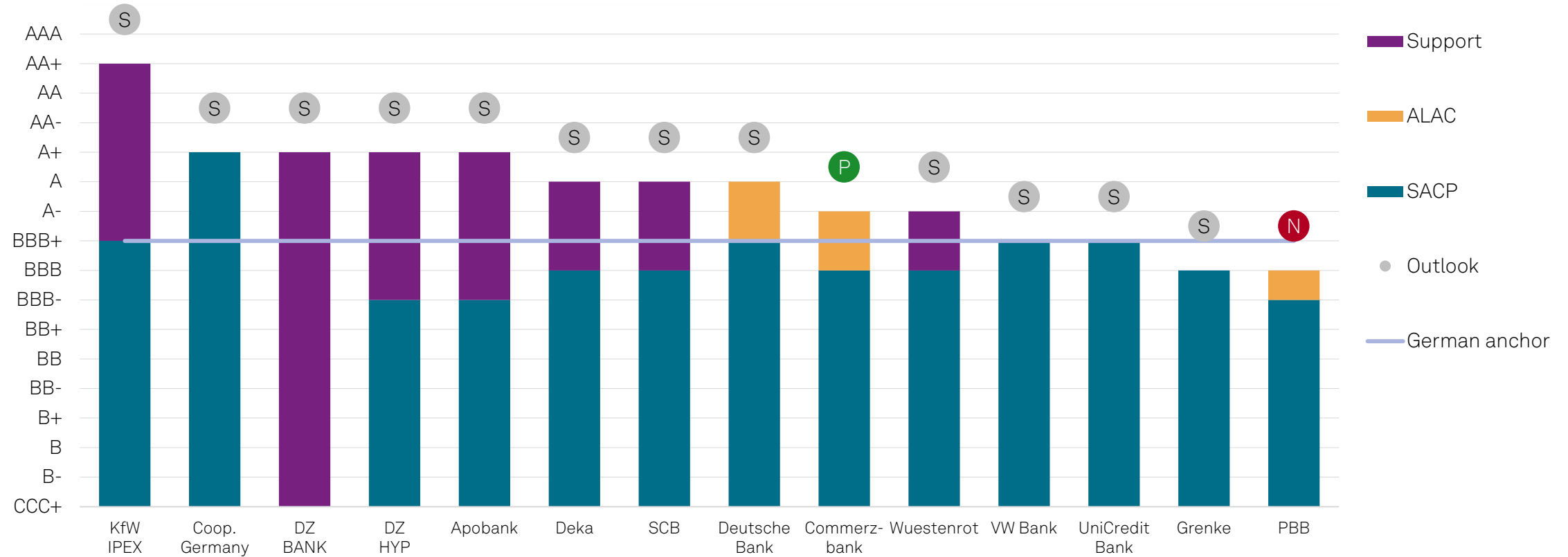
Long-term rates will fall slightly from 2024



Note: Figures are yearly averages. F--Forecast. Source: S&P Global Ratings.

Mostly Stable Outlooks Reflect Expected Bank Resilience

Positive rating actions in 2023 were mostly driven by improving profitability at individual banks. Negative rating actions and outlooks were linked to weaker performance and asset quality prospects.



Note: Support means government support from Germany in the case of KfW IPEX and group support for all other entities. ALAC--Additional loss absorbing capacity. PBB--Deutsche Pfandbriefbank AG. SCB--Santander Consumer Bank. There is no separate SACP for DZ Bank. SACP--Stand-alone credit profile. Source: S&P Global Ratings.

Key Catalysts For German Banks In 2024 And Beyond

Potentially positive or negative factors for rated German banks' resilience

Upside

- Positive revenue trends, despite an expected peak in cyclical interest rates in 2024, for example due to new sources of recurring fee income.
- Improving economic sentiment and outlook (and new lending volumes returning to more meaningful levels) helping to support interest income.
- Increasing earnings retention from improved earnings could be positive for bank creditors.
- Business model diversification into services linked to an established franchise and that have some competitive advantage.
- Banking market consolidation that reduces overcapacities and streamline cost structures.
- Significant progress in digitalization of operating models that reduces structural costs, closes the skills gap, and creates innovative financial services.

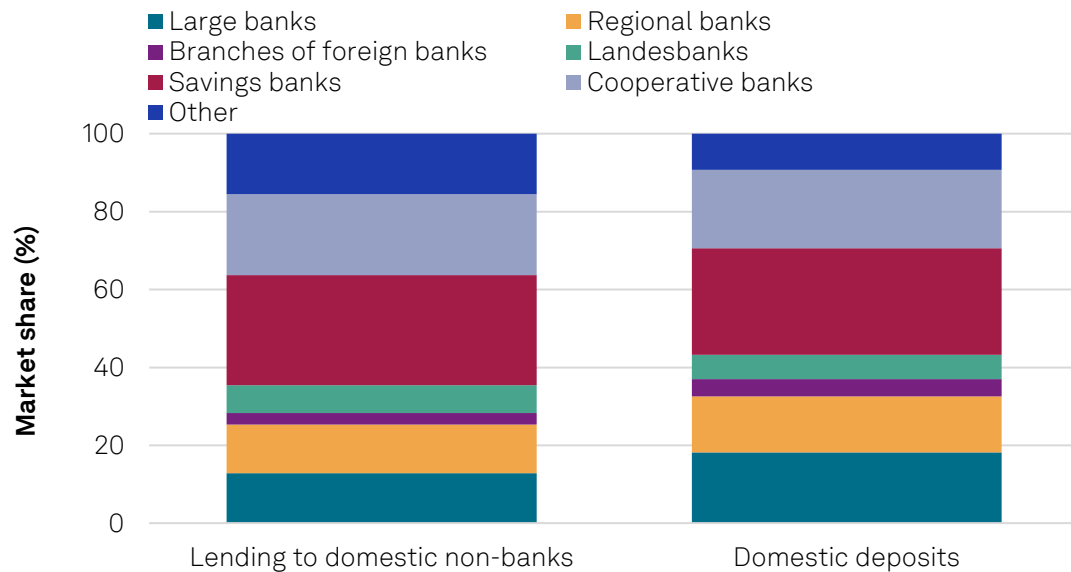
Downside

- Meaningful increase in unemployment rates implying pressure on house prices and the asset quality of mortgage and consumer finance portfolios.
- Materializing (geo)political risk that triggers financial instability and capital market valuation losses. Lower asset values would also put considerable pressure on fees from asset management.
- Acceleration of depositor migration to fixed term products and an increase in betas, towards historical levels, would pressure interest income, particularly once policy rate starts to fall.
- Intensifying competition for deposits could negatively impact earnings, funding stability, and liquidity buffers at banks with weaker franchises.
- Negative regulatory interventions. like a hike in minimum required reserves for eurozone banks, could hurt German banks' revenues and liquidity both materially and more than in peer countries.
- Significant market share losses by domestic banks.

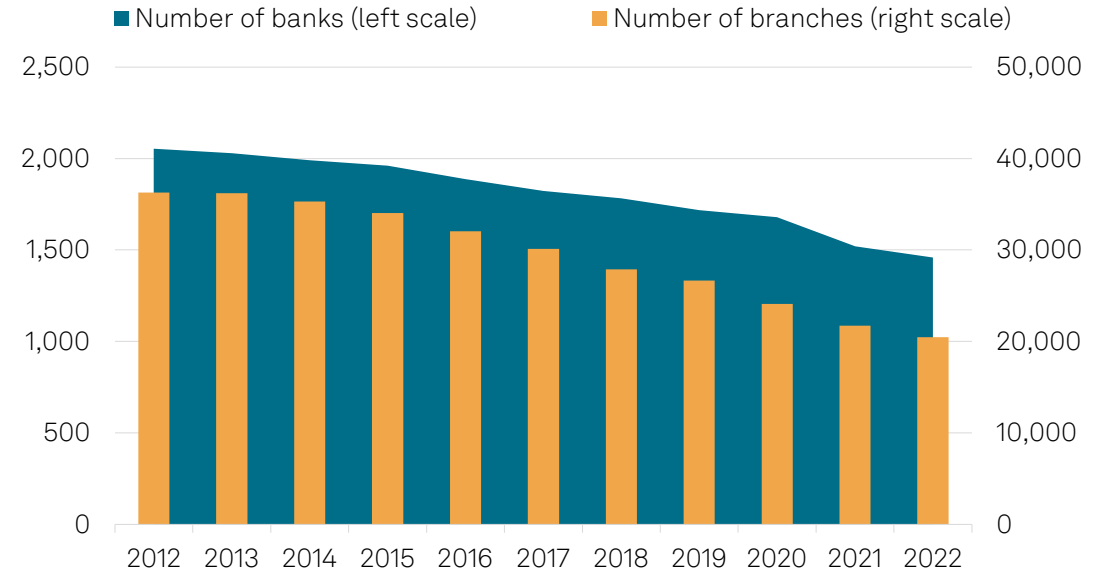
Cooperative And Savings Banks Remain Domestic Market Leaders

Consolidation occurred primarily within sectors and mainly among smaller banks

Market shares in domestic lending and deposits have been relatively stable over the last decade



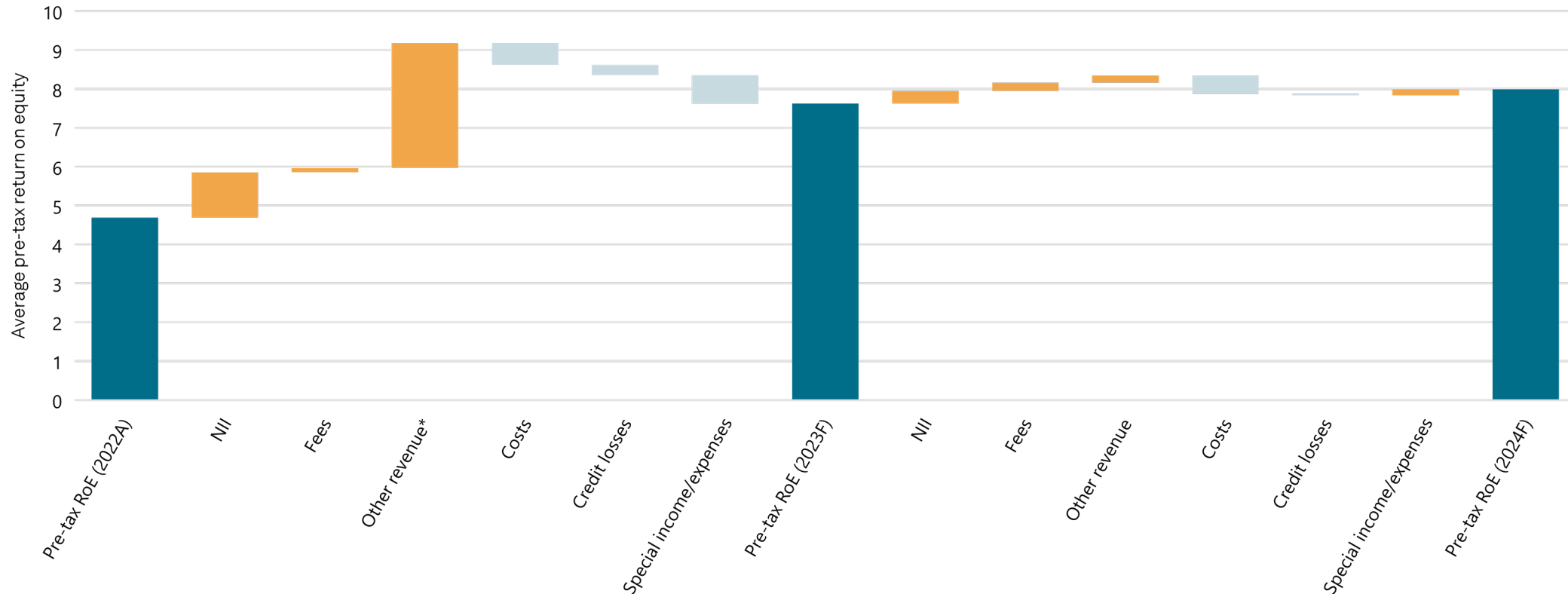
The reduction in branches exceeded number of mergers among mainly local cooperative banks



Note: Domestic deposits comprise of deposits to domestic corporates and private individuals, public households. The wider savings banks sector includes Landesbanks. Source: Bundesbank.

We Expect Profits To Improve Only Slightly As Rate Hike Support Fades

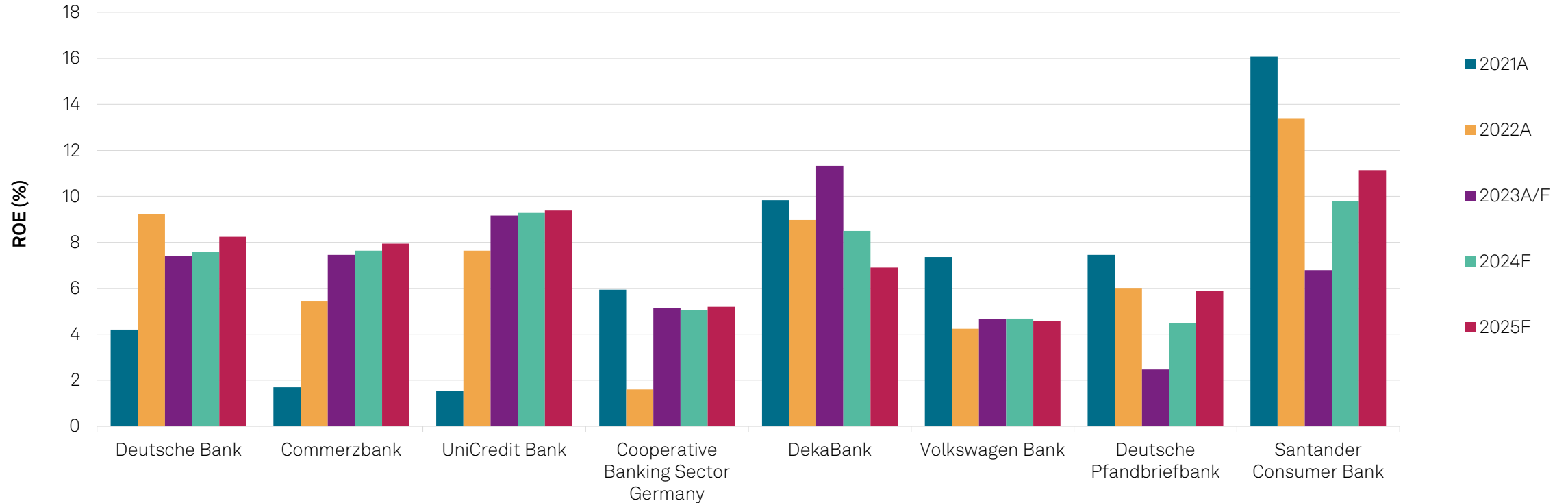
Local cooperative and savings banks are recovering from large but temporary valuation losses, in 2022, and we forecast only a moderate aggregate increase in credit losses for rated German banks



Note: Calculations based on a sample of rated German banks. Cooperative and savings banks' profitability has been adjusted for allocations to reserves under German GAAP 340F and 340G. *The chart includes German savings and cooperative banks that faced large revaluation losses in 2022, which we account for under "other revenues". A--Actual. F--Forecast. RoE--Return on Average Common Equity. Source: S&P Global Ratings.

Interest Rate Tailwinds Have Likely Reached A Cyclical Peak

German banks earnings have improved and become more consistent, while the cooperative sector will recover from valuation losses

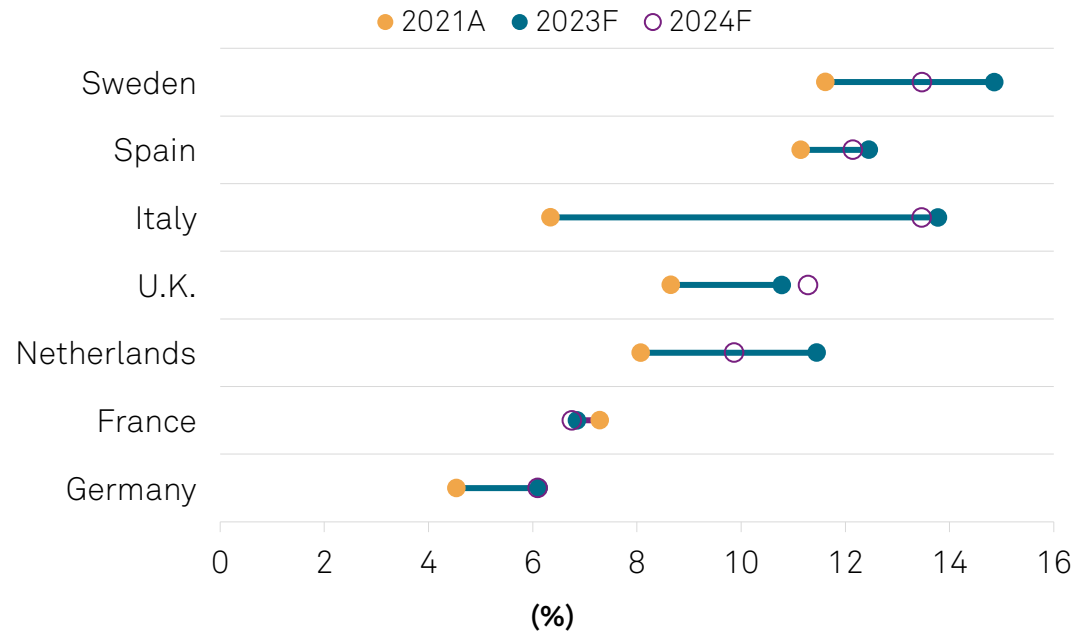


A--Actual. F--Forecast. ROE--Return on average common equity. Source: S&P Global Ratings.

German Banking Sector Profitability Lags European Peers

Returns in Germany benefit from rising rates

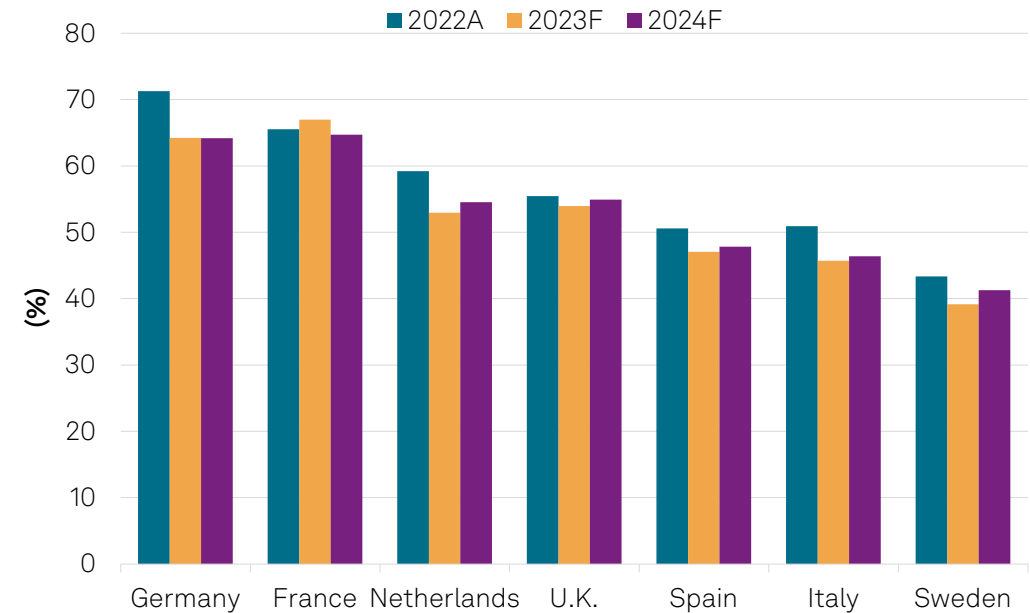
Weighted* average return on average common equity for rated European banks



*Weighted by assets. A--Actual. F--Forecast. Source: S&P Global Ratings.

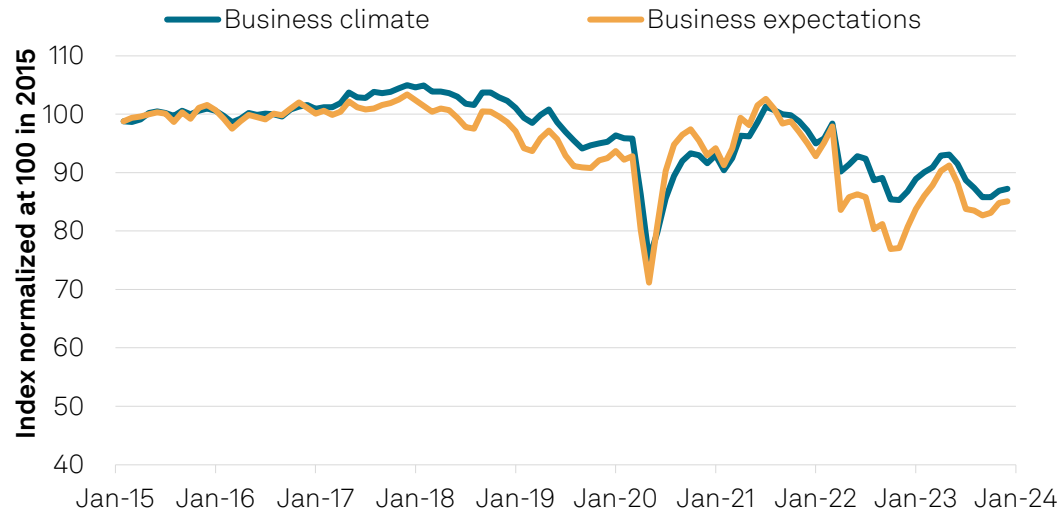
But efficiency will remain an issue for domestic banks

Weighted* average cost-to-income ratio for rated European banks



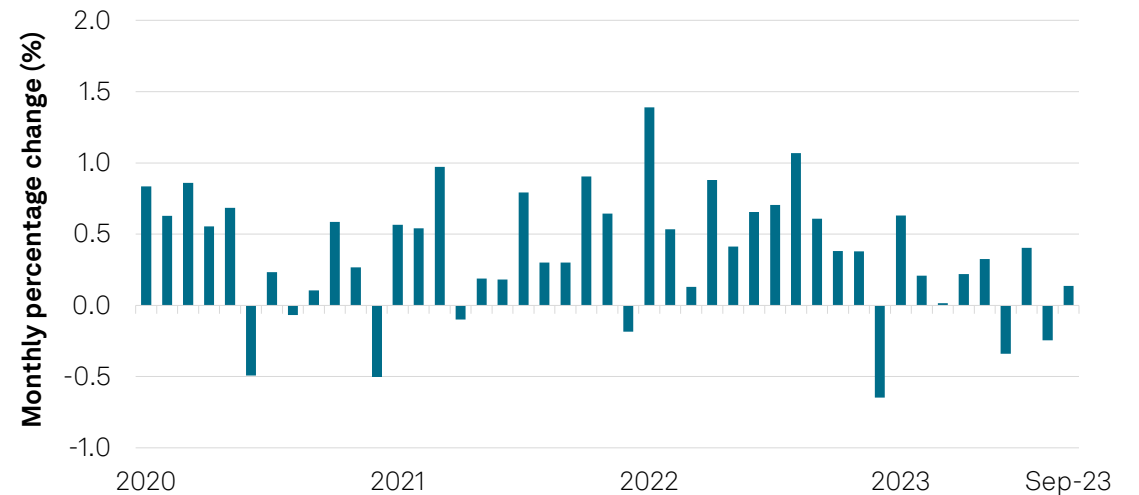
Downbeat German Corporates Remain Skeptical About 2024

Ifo Business Climate Index reflects the negative mood in the German economy



Note: Based on about 9,000 monthly responses from businesses in manufacturing, the service sector, trade, and construction. Companies are asked to give their assessments of the current business situation and their expectations for the next six months. The business climate is a transformed mean of the balances of the business situation and the expectations. Source: Ifo Institute.

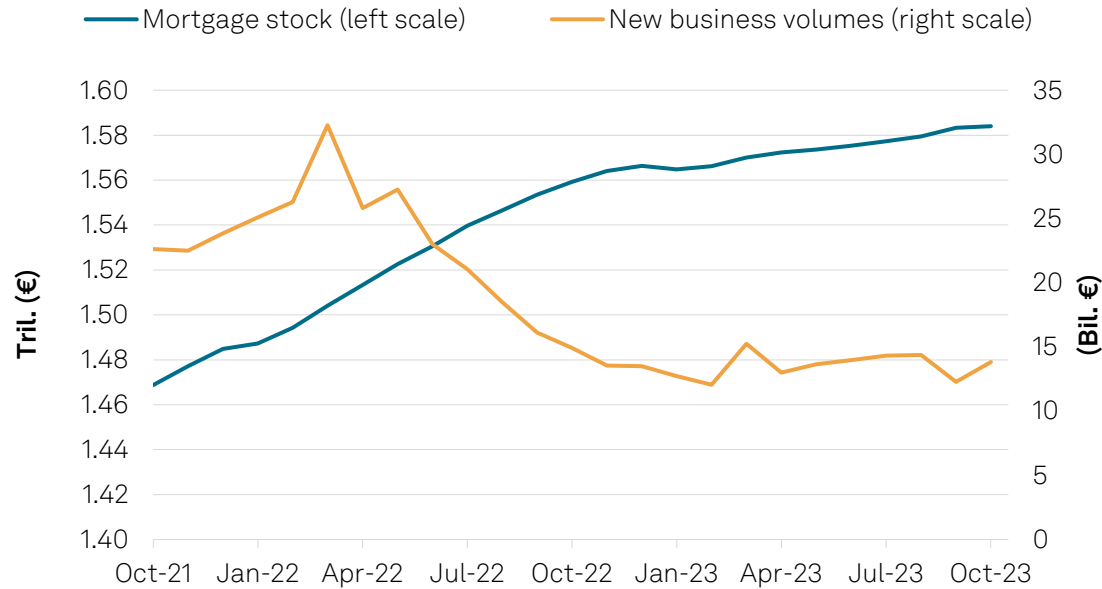
Credit demand in Germany remains muted, which limits improvements in portfolio lending margins



Note: Figures relate to aggregated lending volumes to non-banks. Source: Bundesbank.

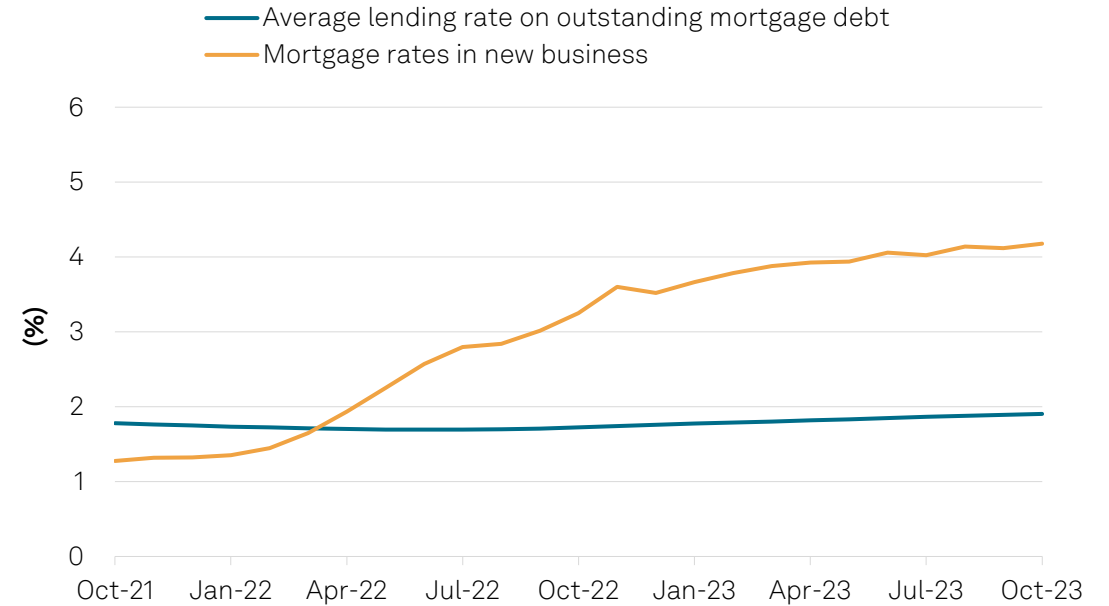
Interest Margins Did Not Benefit From Increasing Mortgage Rates

Demand for mortgage financing has fallen sharply and portfolio growth could soon turn negative



Source: Bundesbank.

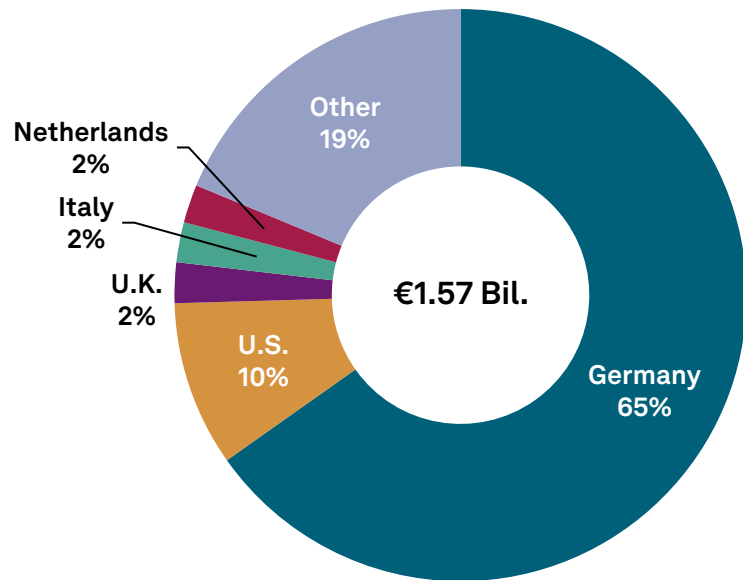
Improvements in mortgage portfolio lending margins is limited due to the prevalence of long-term fixing and limited demand for new loans



Credit Losses Will Remain Manageable For The German Banking Industry

Large German banks have a domestic focus but also meaningful exposure to the U.S., mainly through CRE

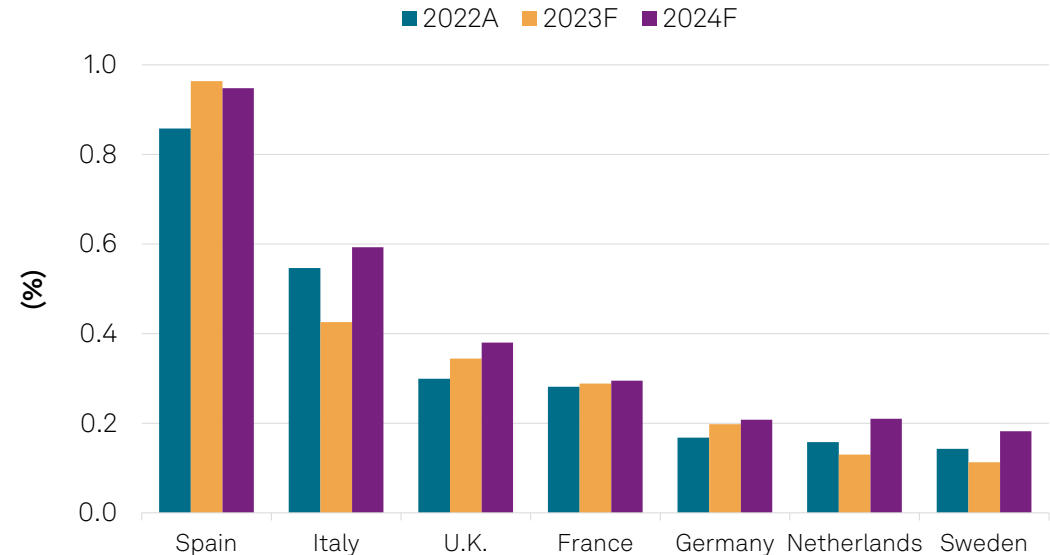
Large German banks' retail and corporate exposure by country



Note: The EBA Stress Test 2023 involved 70 banks from 16 EU and EEA countries, covering 75% of the EU's banking sector assets. Source: EBA Stress Test 2023.

Credit Losses will remain at favourable levels for German banks despite economic headwinds

Weighted* average credit losses for rated European banks

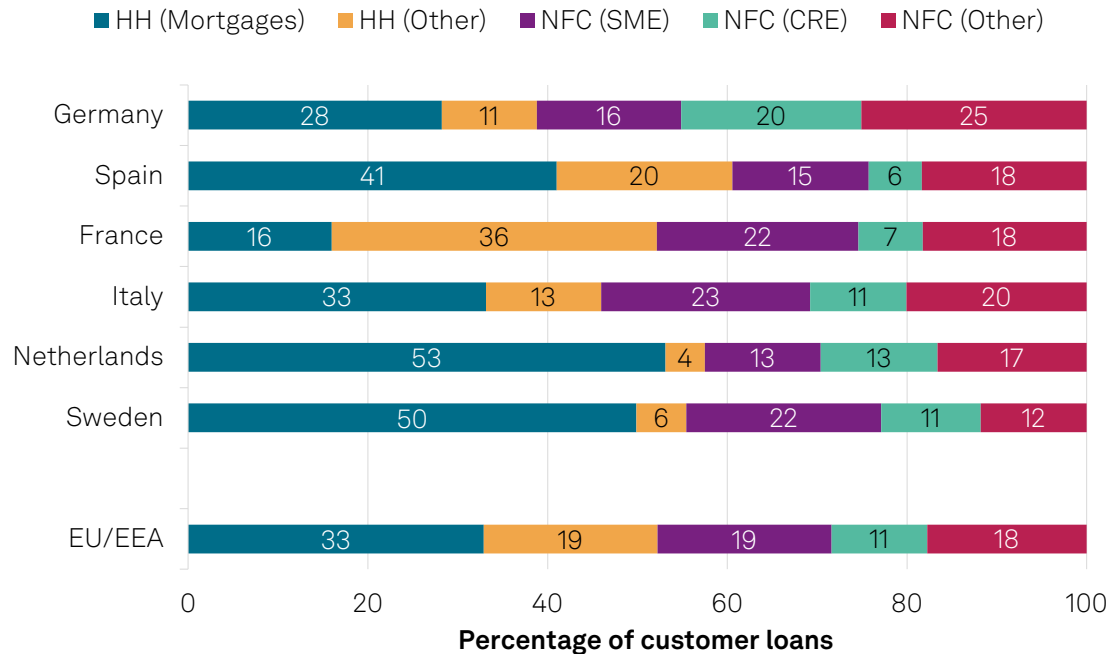


*Weighted by assets. A--Actual. F--Forecast. Source: S&P Global Ratings.

Exposure To Higher Risk Segments Appears Manageable

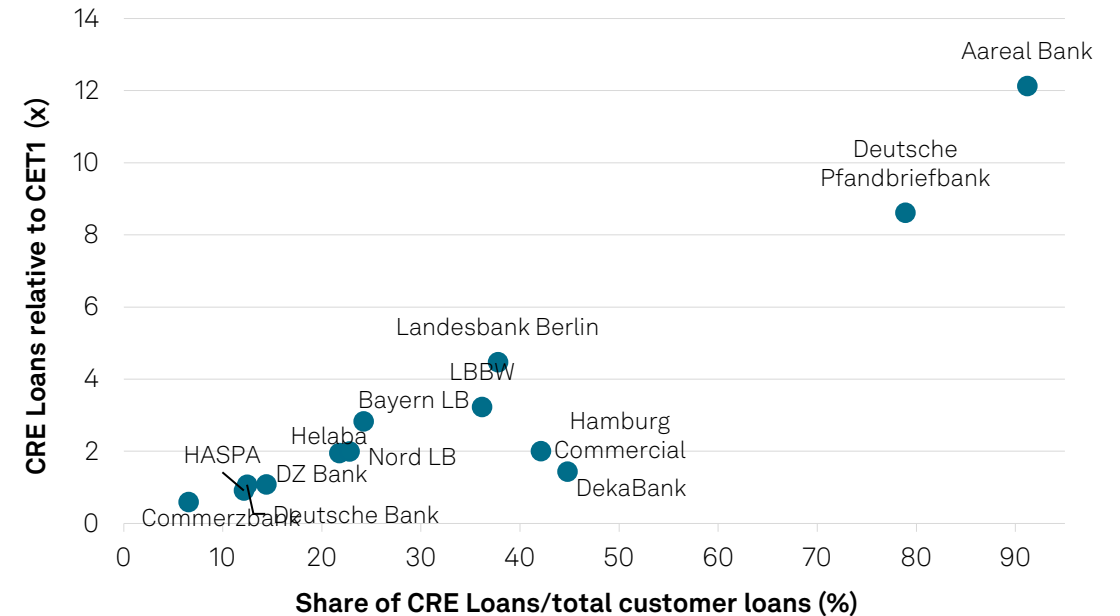
Large German banks have higher CRE exposure

Breakdown of lending exposures of large European banks



But CRE is mainly concentrated in specialized lenders.

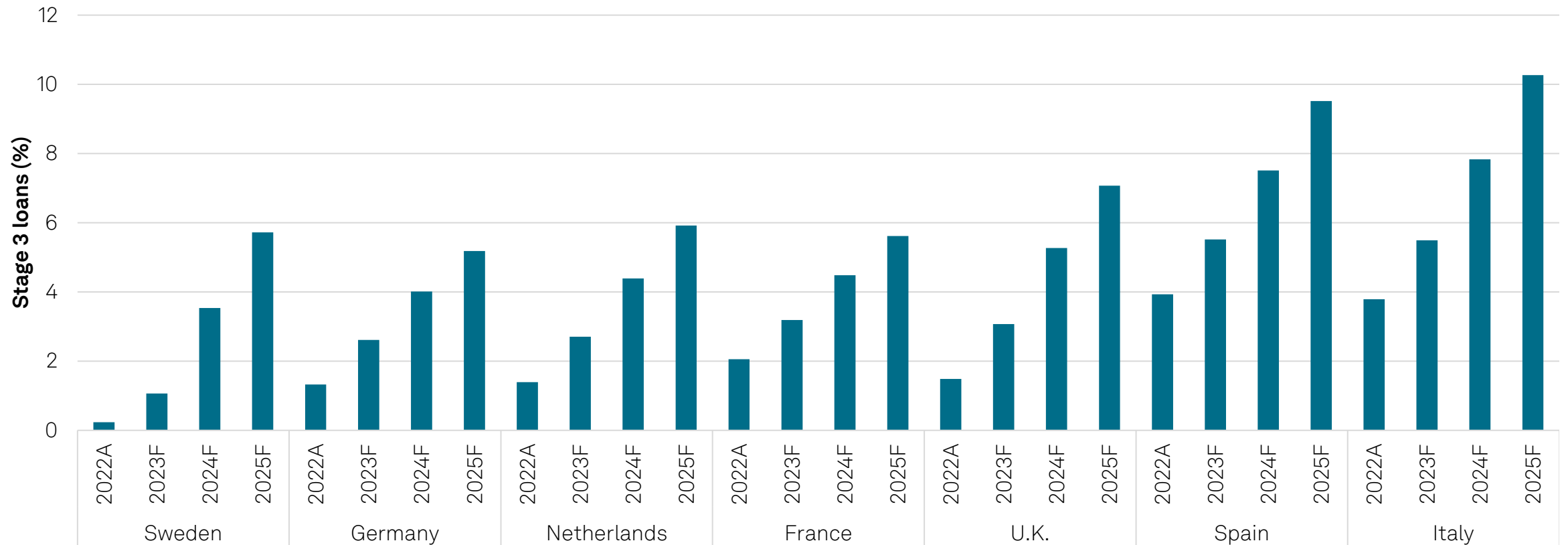
CRE loans relative to customer loans and CET1 capital



*Total customer loans is the sum of loans to households and nonfinancial corporations. HH--households. NFC--Non-financial corporation. CET1--Common equity tier 1 capital. Customer loans--loans at amortized cost towards households and nonfinancial corporations. Source: EBA Transparency Exercise as of end-September 2023.

Moderate Increase In Stage 3 Loans In Adverse Scenario

The EBA Stress Test 2023* indicates a relatively mild increase in non-performing German lending

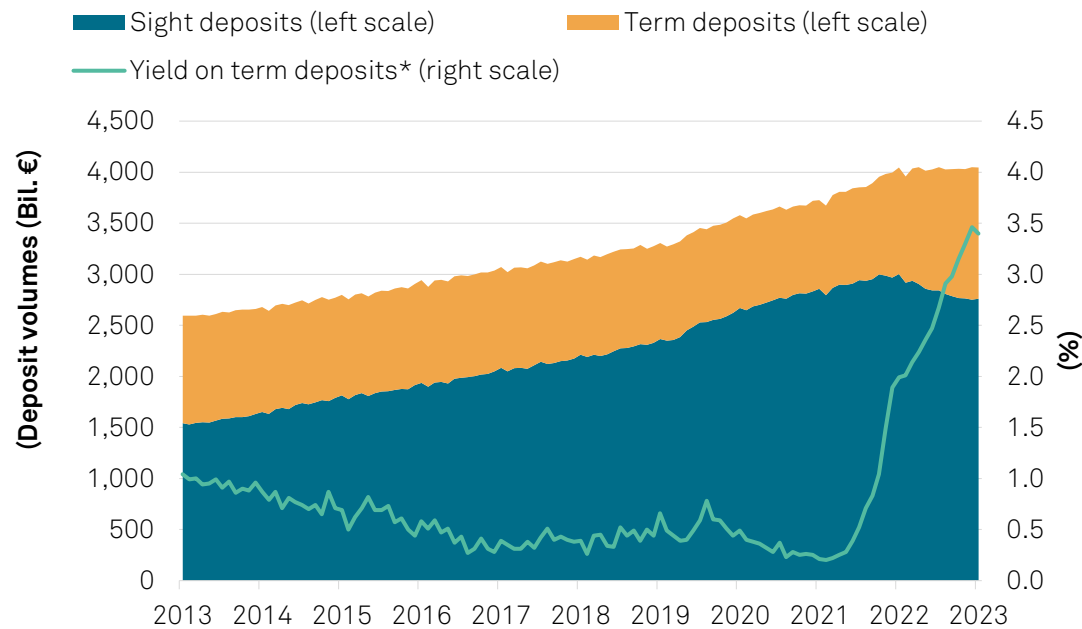


*The EU-wide stress test involved 70 banks from 16 EU and EEA countries, covering 75% of the EU banking sector assets. The adverse scenario was characterized by severe negative shocks to economic growth, higher unemployment, and higher interest rates and credit spreads. A--Actual. F--Forecast. EBA--European Banking Association. Source: EBA Stress Test 2023.

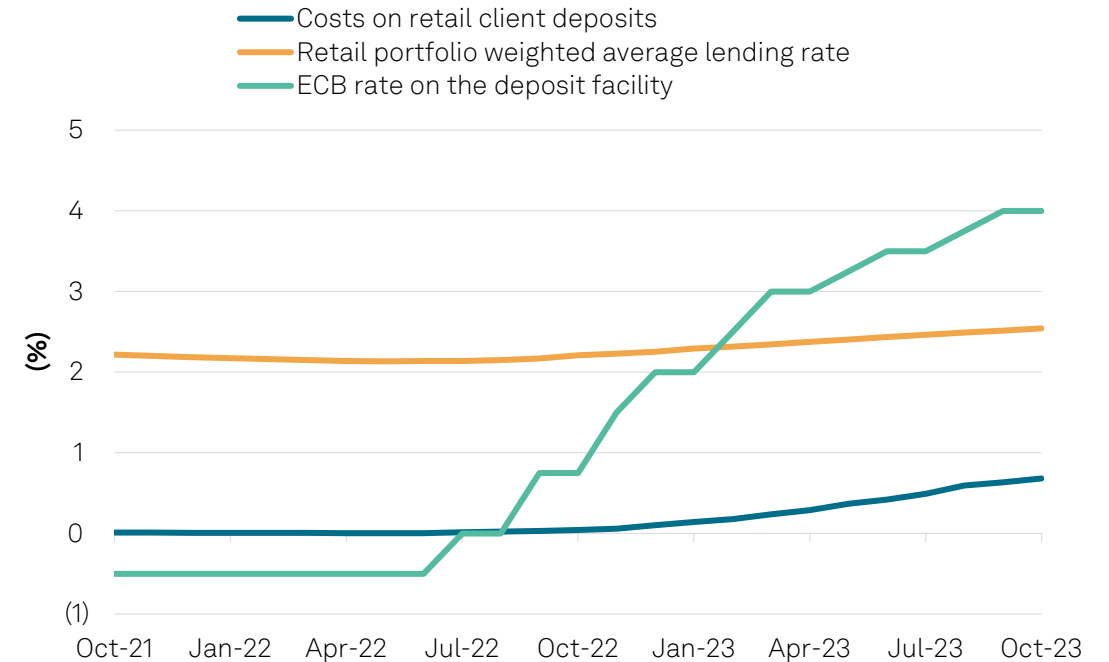
German Customers Are Adapting To Higher Interest Rates

The shift towards term deposits is ongoing

Sight and term deposit volumes and new term deposit yield



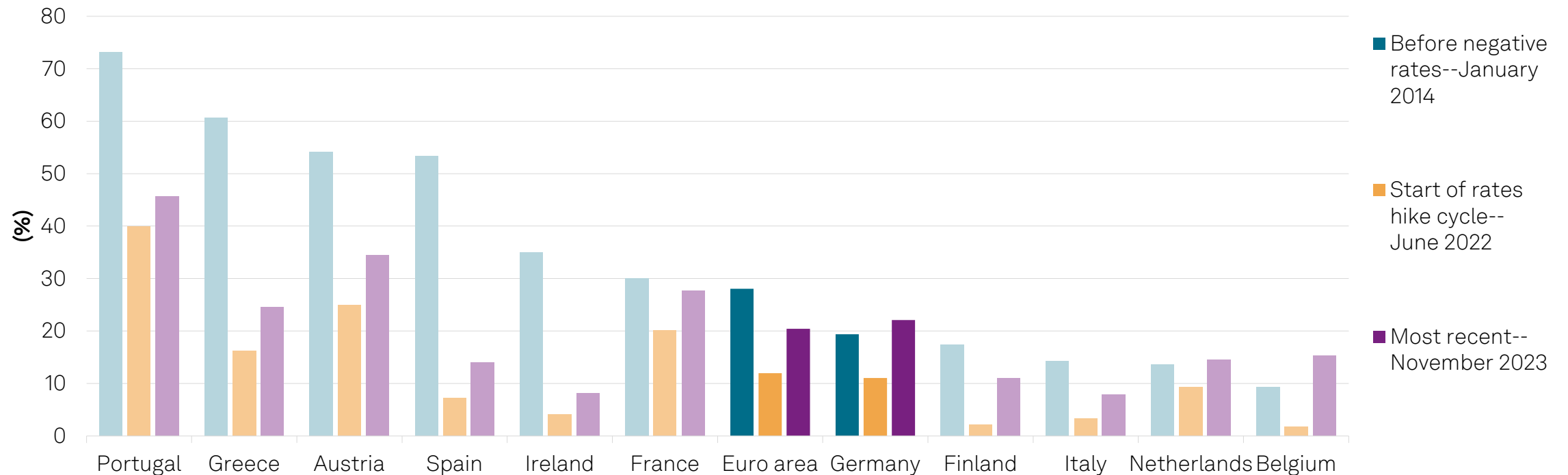
In retail business, average deposit rates will likely grow faster than portfolio returns§



*Yield refers to term deposits in new business with tenor between one and two years. §Return calculated on volumes of outstanding mortgage and consumer financing. Source: Bundesbank. Deposits to non-banks.

Germany's Recent Migration Toward Fixed-Term Products Mirrors The European Average

Fixed-term customer deposits (households and retail) as a percentage of total deposits

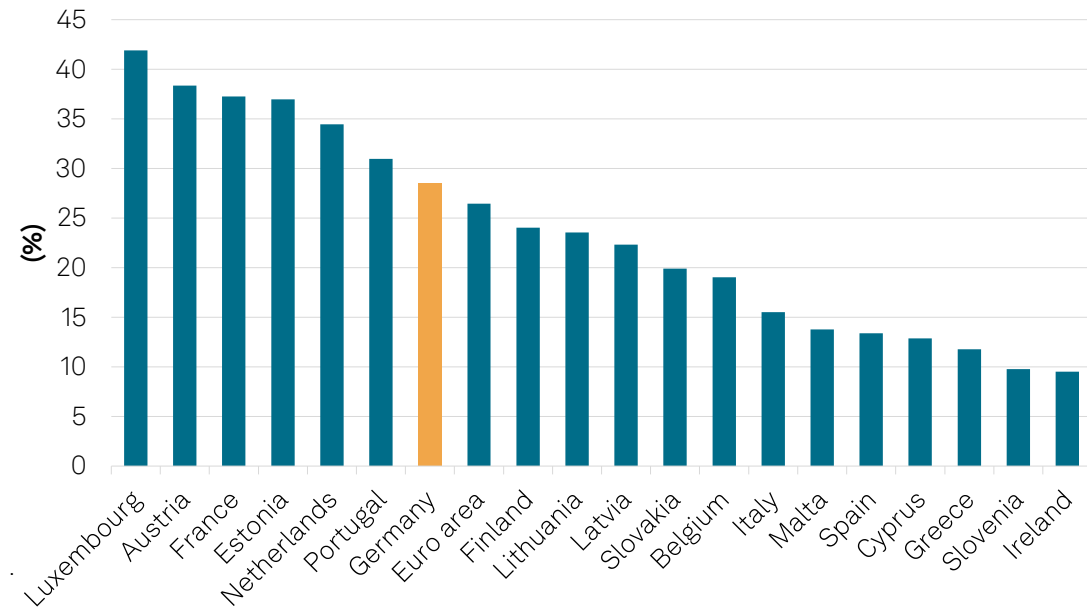


Source: European Central Bank.

Banks' Deposit Costs Continue Increasing

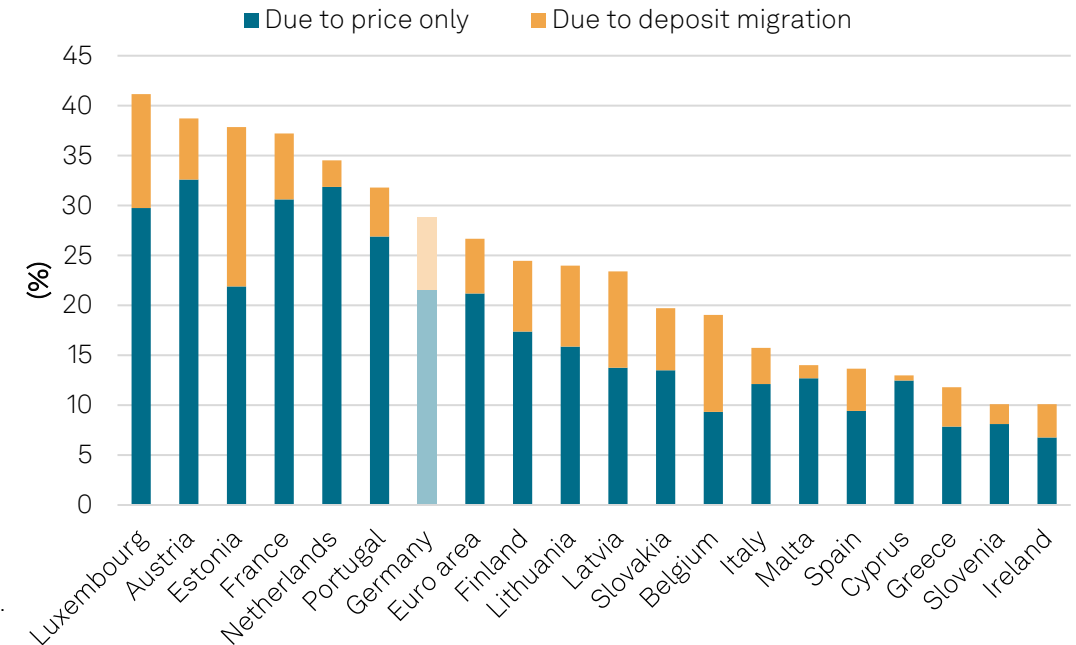
Deposit betas in Germany are in line with the euro area average

Deposit betas for large eurozone banks: June 2022-November 2023



Increased deposit costs in Germany are mainly attributable to repricing of sight deposits

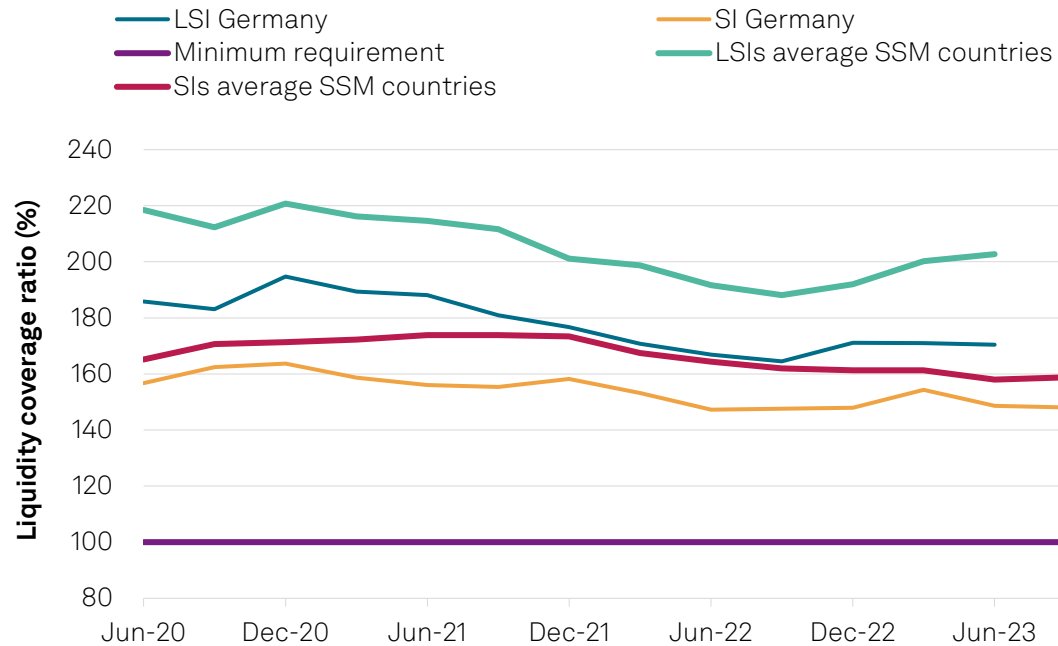
Deposit beta composition



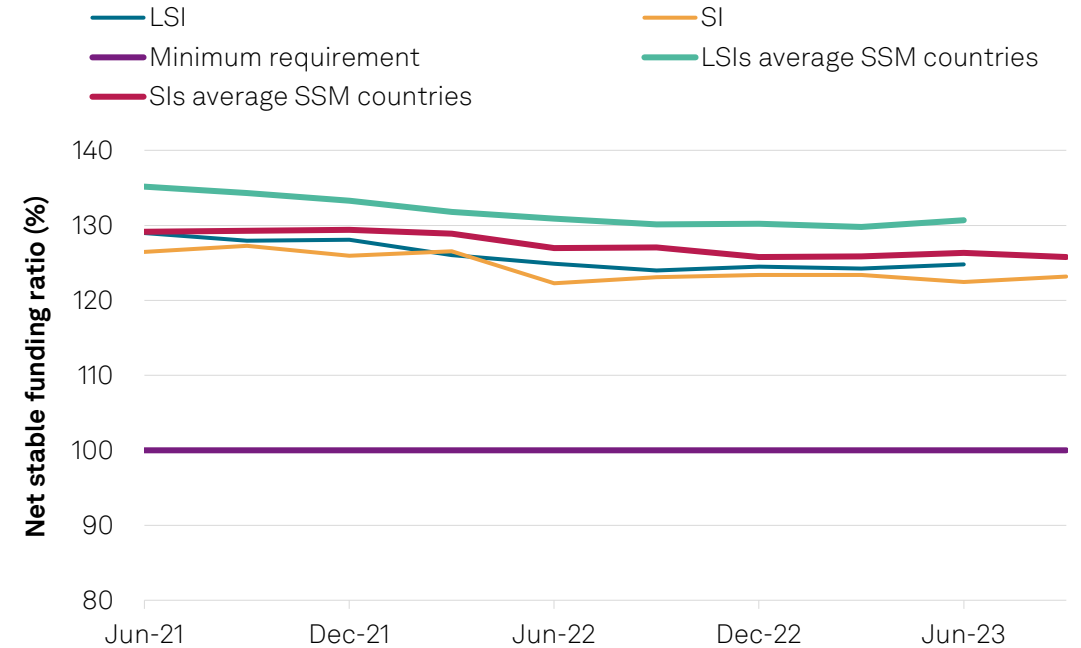
Note: Deposit beta is the share of the European Central Bank's policy rate increases that banks have passed on to rates on new deposits. Includes all types of deposits. Source: European Central Bank.

German Banks Have Solid Liquidity And Funding Metrics

Buffers should remain comfortable as ECB monetary tightening will reduce systemic bank reserves

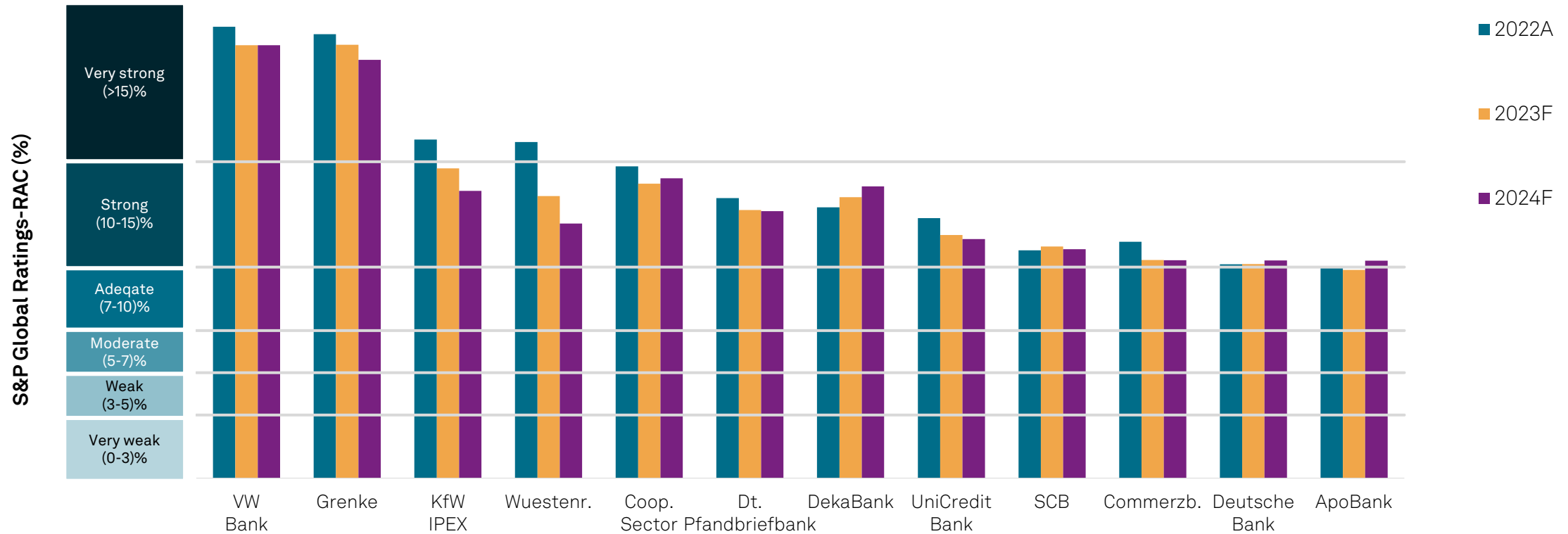


German banks' buffers are below the European average but still easily exceed minimum requirements



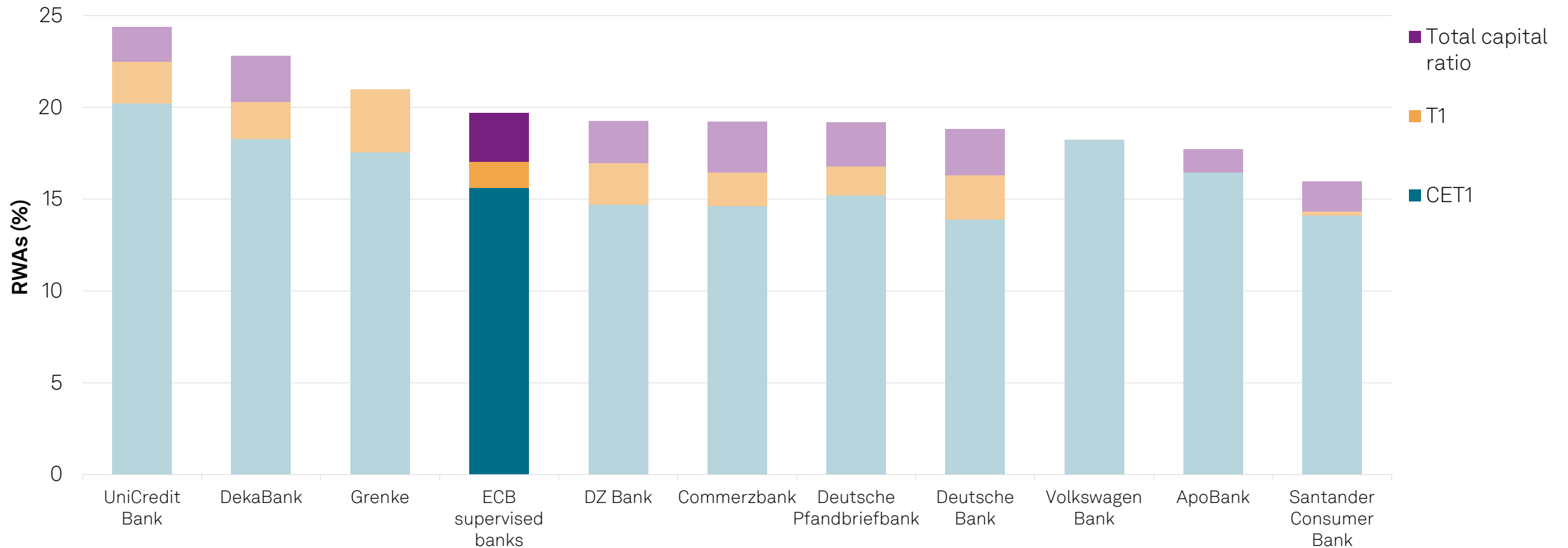
Note: Less-significant institutions (LSIs) are small and medium-sized banks that are directly supervised by their national competent authorities, whereas significant institutions (Sis) are directly supervised by the ECB. For LSIs no third-quarter 2023 data is available. LSI--Less-significant institutions. SI--Significant institutions. SSM--Single Supervisory Mechanism. ECB--European Central Bank. Source: ECB.

Risk-Adjusted Capitalization Is A Rating Strength For Many German Banks, Despite Increasing Economic Risk



A--Actual, F--Forecast, RAC--Risk-adjusted capital ratio. Note: For Deutsche Bank and Deutsche Apotheker- und Aerztebank (ApoBank) we apply a negative adjustment to the initial capital and earnings score given that RAC is only marginally above 10%. For Commerzbank we expect RAC to decrease below 10% from 2025. 2022 figures are based on economic risk of 1 for Germany, while forecast figures reflect our revised economic risk of 2, since February 2023. Source: S&P Global Ratings.

German Bank Have Solid Capital Buffers Above Regulatory Minima And In Line With Average Of Large Eurozone Banks



Data as of September 2023, phased-in. RWAs--Risk weighted assets. T1--Tier 1. CET1--Common equity tier 1 capital. Sources: S&P Global Ratings, Individual bank reporting and from European Banking Authority's Transparency Exercise as of end-June 2023. Q2 data for Grenke and Santander Consumer Bank.

Key Risks For German Banks In 2024



A protracted, painful recession leading to a sharp increase in unemployment and material asset quality decline

Banks could adopt protective measures (tighter underwriting, higher provisions) that reduce profits.



A faster-than-expected rise in funding costs propelled by deposits

Access to cheap, stable customer deposits will be particularly valuable to banks with significant term-funding concentrations.



Rising operational costs due to core inflation stress

Cost-cutting ambitions are likely to be curtailed if core inflation persists even as headline inflation eases.



Market volatility triggering financial instability

Materializing geopolitical risks or higher could pressure nonbank financial institutions' leverage and liquidity, and ultimately unearth dangers to the broader financial system.

Related Research

- [Deutsche Pfandbriefbank AG](#), Jan. 23, 2024
- [Cooperative Banking Sector Germany](#), Jan. 9, 2024
- [EU Banking Package: Inconsistencies Temper Framework Improvements](#), Jan. 9, 2024
- [KfW IPEX-Bank GmbH](#), Jan. 5, 2024
- [Commerzbank AG](#), Dec. 18, 2023
- [Bulletin: Germany-Based UniCredit Bank AG's Change In Legal Status Has No Direct Credit Implications](#), Dec. 18, 2023
- [Update: Deutsche Bank AG](#), Dec. 12, 2023
- [DekaBank Deutsche Girozentrale](#), Dec. 1, 2023
- [Europe's Sovereign-Bank Nexus: Old Habits, New Risks](#), Nov. 30, 2023
- [European Banks: Cyclical Earnings Boost Is No Panacea](#), Nov.21, 2023
- [Volkswagen Bank GmbH](#), Nov. 07, 2023
- [Eurozone Banks: Higher Reserve Requirements Would Dent Profits And Liquidity](#), Oct 24, 2023
- [L-Bank Rating Outlook Revised To Positive After Similar Action On State Of Baden-Wuerttemberg: Affirmed At 'AA+/A-1+', Oct 06, 2023](#)
- [Wuestenrot Bausparkasse AG](#), Sep. 25, 2023
- [DZ Bank AG Deutsche Zentral-Genossenschaftsbank](#), Aug. 10, 2023
- [Santander Consumer Bank AG](#), Aug. 8, 2023
- [Grenke AG](#), Jul. 27, 2023
- [Deutsche Apotheker- und Aerztebank eG](#), Jul. 06, 2023
- [DZ HYP AG](#), Jun. 21, 2023
- [NRW.BANK](#), Feb. 16, 2023

Analytical Contacts

Benjamin Heinrich

Frankfurt

+49 693 399 9167

benjamin.heinrich@spglobal.com

Heiko Verhaag

Frankfurt

+49 693 399 9215

heiko.verhaag@spglobal.com

Harm Semder

Frankfurt

+49 693 399 9158

harm.semder@spglobal.com

Claudio Hantzsche

Frankfurt

+49 693 399 9188

claudio.hantzsche@spglobal.com

Lukas Freund

Frankfurt

+49 69 3399 9139

lukas.freund@spglobal.com

Richard Barnes

London

+44 (7773) 641881

richard.barnes@spglobal.com

Karim Kroll

Frankfurt

karim.kroll@spglobal.com

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