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OUTLOOK
28 October 2021

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Banking System Outlook Update - Germany

Solid credit performance shifts our outlook to stable from negative

We have changed our outlook for the banking sector in Germany (Aaa stable) to stable from negative. The change primarily reflects our expectation that credit fundamentals for German banks will remain stable over the coming 12 to 18 months. We expect a measured increase in problem loans and loan-loss provisions in 2022 as pandemic support measures for the economy are gradually unwound. Rising problem loans will increase risk-weighted assets, the denominator of the capital ratio, but banks will be able to cover the resulting rise in capital needs by retaining the bulk of their profits. Profitability continues to be challenged by structural weakness, but is gaining some temporary support from improving fee and commission income and windfall profits from the European Central Bank's (ECB) targeted longer-term refinancing operations (TLTRO).

Strong government support has delayed loan book quality deterioration and bought the private sector time to recover. Substantial support provided to households and companies by the German government in response to the COVID-19 pandemic has eased pressure on the private sector and buoyed spending. Increased spending has, in turn, helped to propel the recovery, especially since households accumulated substantial savings during the pandemic. We forecast that real GDP will rebound in 2021 and 2022. Supply chain bottlenecks challenge the global trade rebound, and delay its contribution to the recovery of the German economy, which is highly export-oriented. Despite the recent rise in inflation, we expect interest rates in Germany to remain ultralow, keeping up the pressure on bank revenues.

Problem loans will rise only moderately as remaining government support measures end. Loan impairments and the migration of loan book exposures to higher risk classifications were limited in 2020 and have remained so in 2021. We expect loan repayment difficulties to become more prominent in 2022 with problem loans rising, but remaining below 3% of gross loans. We expect the performance of residential and commercial real estate loans, which are of high relevance for German Banks and which mostly benefit from disciplined underwriting by these, to remain stable.

Capital will stay solid. German banks will maintain strong capital levels, supported by measured dividend payout ratios despite a temporary rise in profits. An increase in risk-weighted assets related to a moderate rise in loan book risk and in anticipation of tightened Basel III rules in 2023 will offset the positive effect of earnings retention on the banks' capital ratios.

Revenues will temporarily improve; provisioning needs will rise modestly. The revenue mix of German banks will shift lightly in 2021 towards fee and commission as well as trading income derived from stronger capital markets activities and securities business. German banks will gain short-term benefit from negative interest rates on TLTRO borrowings from the ECB, helping them offset lower net interest margins, particularly in retail banking. Cost management is well recognised by bank management teams as necessary to counterbalance their limited options to improve revenues but will have to gain momentum and requires diligent execution. Tangible short-term cost benefits will however remain scarce in light of continued investment needs, mainly in technology.

Access to funding will remain strong and stable. German banks have access to a diversified set of funding tools, including a broad retail deposit base and a well-established domestic covered bond (Pfandbrief) market. This reduces the banks' dependence on confidence-sensitive, unsecured market funding sources. Banks have opportunistically accessed the ECB's attractively priced TLTRO funding programmes, with drawings overwhelmingly held as excess balances of cash or liquid securities.

Our view on government support in the event of a bank failure is unchanged. There is a moderate likelihood of government support for the largest, most systemically important banks only.

Exhibit 1

Overview of key drivers for Germany's stable banking system outlook

Operating environment	**Stable**	+	Significant excess savings held by German households will result in catch-up demand for consumer goods and services; global trade volumes have recovered to pre-pandemic levels.
		-	High global interconnectedness of German economy could threaten economic growth amid disruption in industrial supply chains, high energy prices and a potential slowdown in China's economy.
Asset risk	**Stable (previously deteriorating)**	=	Prudent underwriting and a high degree of collateralisation will support continued sound performance of German banks' loan books.
		-	During 2022, reduced public support for the private sector will lead to a rise in insolvencies and problem loans.
		=	We expect stable credit performance in the key residential and commercial real estate lending segments.
Capital	**Stable**	+	Measured dividend policies will allow for some profit retention.
		-	Growth in risk-weighted assets will reflect continued balance sheet growth and weakening financial profiles of corporate borrowers.
Profitability and efficiency	**Stable (previously deteriorating)**	-	Sustained interest margin pressure will be largely offset by increasing fee and provision income from capital markets and securities business, but loan loss provisions will rise.
		=	Management awareness of the importance of cost management in developing sustainable business models is increasing.
		+	Temporary support from windfall payments under the ECB's targeted longer-term refinancing operations (TLTRO III)
Funding and liquidity	**Stable**	+	Banks have good access to well diversified pools of deposits, covered bonds and senior unsecured funding. The ECB's TLTRO funding programme has supplemented these options at attractive terms.
		=	Most German banks will maintain sound liquidity buffers despite pressure on net interest margins.
		=	Large banks already comply with MREL requirements for a layer of bail-in debt. They will tend to replace maturing junior senior (non preferred senior) bonds with senior preferred funding, which enables them to make use of their funding mix flexibility.
Government support	**Stable**	=	German banks operate under the EU's resolution regime for failing banks, the BRRD, under which losses are primarily borne by shareholders and debtholders. We therefore assume there is little likelihood of government support for many banks and only a moderate likelihood of support for the senior debts and deposits of the banks and members of banking groups that are vital for the stability of the German financial system. We do not expect to change our view over the outlook horizon.

Source: Moody's Investors Service

Exhibit 2
Aggregate key indicators for our rated German banks

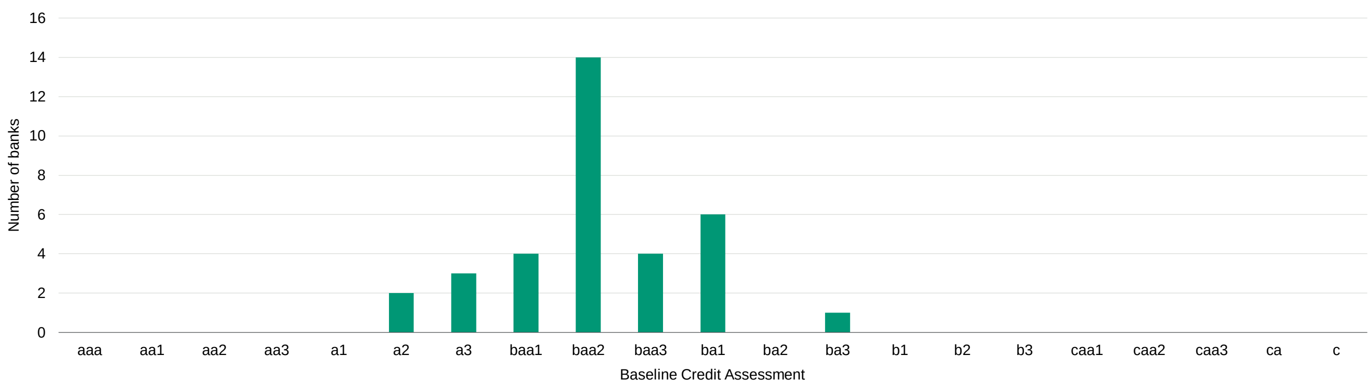
Core Scorecard Ratios	1H 2021	2020	1H 2020	2019	2018	2017	2016
Problem Loans / Gross Loans	2.0%	2.0%	2.1%	1.7%	2.1%	2.5%	3.1%
Tangible Common Equity / Risk Weighted Assets	15.4%	15.9%	15.1%	16.0%	15.7%	16.4%	14.9%
Net Income / Tangible Assets	0.3%	0.1%	0.1%	0.1%	0.1%	0.2%	0.1%
Market Funds / Tangible Banking Assets	42.2%	38.7%	41.7%	36.9%	38.0%	37.4%	39.7%
Liquid Banking Assets / Tangible Banking Assets	42.4%	39.3%	38.7%	36.3%	38.7%	41.1%	40.0%
Additional Ratios							
Loan Loss Reserves / Problem Loans	58.0%	63.8%	57.3%	58.2%	57.5%	56.9%	53.9%
Tier 1 Ratio	16.3%	16.7%	15.3%	16.0%	15.3%	15.8%	15.1%
Tangible Common Equity / Total Assets	4.8%	5.2%	4.8%	5.4%	5.4%	5.3%	5.0%
PPI / Average RWA	1.6%	1.1%	1.0%	1.1%	1.1%	1.4%	1.2%
Cost / Income Ratio	70.5%	75.1%	78.9%	76.8%	78.8%	72.9%	76.1%

Notes: All ratios are asset-weighted averages for our rated banks and may be adjusted to reflect our analytical views. We exclude Sparkassen-Finanzgruppe, banks without a separate Baseline Credit Assessment (including development banks and highly integrated and harmonised entities) as well as rated banks consolidated in banking groups included in the sample to avoid double-counting. Historic ratios may differ from previous outlooks, given changes in the sample of rated bank.
Source: Moody's Investors Service

Rating universe

German banks' Baseline Credit Assessments (BCAs), our view of their stand-alone financial strength, are distributed over an eight-notch range from a2 to ba3 (Exhibit 3). The weighted average German bank BCA is baa2. We rate 45 German credit institutions, including development banks, specialised lenders and public-sector banking associations (Exhibit 4).

Exhibit 3
German bank BCA distribution as of 27 October 2021



Source: Moody's Investors Service

Exhibit 4

Rated German banking groups as of 27 October 2021 (sorted by total assets)

Rated Banks / Groups	Banking Sector	Total Assets (Dec 2020, € billion)	Deposit Rating	Outlook	Senior Unsecured / Issuer Rating	Outlook	Junior Senior Unsecured	BCA
Sparkassen-Finanzgruppe *	public	2383	-	-	Aa2	STA	-	a2
Deutsche Bank AG	commercial	1325	A2	POS	A2	POS	Baa2	baa3
DZ BANK AG	co-operative	595	Aa2	STA	Aa2	STA	A3	baa2
Kreditanstalt fuer Wiederaufbau	development	546	Aaa	STA	Aaa	STA	-	-
Commerzbank AG	commercial	507	A1	STA	A1	NEG	Baa2	baa2
UniCredit Bank AG	commercial	338	A2	STA	A2	STA	Baa2	baa2
Landesbank Baden-Wuerttemberg	public	276	Aa3	STA	Aa3	STA	A2	baa2
Bayerische Landesbank	public	256	Aa3	STA	Aa3	STA	A2	baa2
J.P. Morgan AG	commercial	245	Aa1	STA	Aa3	STA	-	a2
Sparkassenverband Baden-Wuerttemberg	public	223	-	-	Aa3	STA	-	-
Landesbank Hessen-Thueringen GZ	public	219	Aa3	STA	Aa3	STA	A2	baa2
ING-DiBa AG	commercial	190	A2	STA	-	-	-	a3
NRW.BANK	development	156	-	-	Aa1	STA	-	-
Norddeutsche Landesbank GZ	public	126	A3	STA	A3	STA	Baa2	ba3
Volkswagen Financial Services AG	commercial	118	-	-	A3	STA	-	-
Deutsche Kreditbank AG	commercial	110	A1	STA	A1	STA	A2	baa1
Landwirtschaftliche Rentenbank	development	95	Aaa	STA	Aaa	STA	-	-
L-Bank	development	87	Aaa	STA	Aaa	STA	-	-
DekaBank Deutsche Girozentrale	public	86	Aa2	STA	Aa2	STA	A1	baa2
DZ HYP AG	co-operative	82	Aa2	STA	Aa2	STA	A3	ba1
Bausparkasse Schwaebisch Hall AG	co-operative	82	Aa2	STA	Aa2	STA	-	baa2
Citigroup Global Markets Europe AG	commercial	70	-	-	A1	STA	-	-
Volkswagen Bank GmbH	commercial	67	A1	STA	A1	STA	A3	baa2
Deutsche Apotheker- und Aerztebank eG	co-operative	59	Aa1	NEG	(P)Aa2	-	A2	baa1
Santander Consumer Bank AG	commercial	50	A2	STA	A2	STA	-	baa2
Muenchener Hypothekenbank eG	co-operative	49	Aa3	STA	Aa3	STA	A2	ba1
Landesbank Berlin AG	public	49	Aa2	STA	Aa2	STA	A2	baa2
UBS Europe SE	commercial	48	Aa3	STA	Aa3	STA	-	baa1
Aareal Bank AG	commercial	45	A3	NEG	A3	NEG	-	baa3
Hamburg Commercial Bank AG	comm./public**	34	Baa1	POS	Baa1	POS	Baa2	ba1
Berlin Hyp AG	public	33	Aa2	STA	Aa2	STA	A2	ba1
Kreissparkasse Koeln	public	29	Aa3	STA	Aa3	STA	-	a3
Sparkasse KoelnBonn	public	28	A1	STA	(P)A1	-	Baa1	baa2
KfW IPEX-Bank GmbH	commercial	28	Aa2	STA	-	-	-	a3
LfA Foerderbank Bayern	development	23	Aaa	STA	Aaa	STA	-	-
Bayerische Landesbodenkreditanstalt	development	21	Aaa	STA	Aaa	STA	Aaa	-
Oldenburgische Landesbank AG	commercial	21	Baa2	STA	Baa2	STA	-	baa3
IKB Deutsche Industriebank AG	commercial	16	Baa1	STA	Baa1	STA	-	baa3
Landesbank Saar	public	15	A1	STA	A1	STA	-	ba1
Morgan Stanley Bank AG	commercial	9	Aa3	STA	Aa3	STA	-	baa1
Debeka Bausparkasse AG	commercial	9	Baa3	NEG	-	-	-	ba1
Siemens Bank GmbH	commercial	8	-	-	A1	STA	-	-
Standard Chartered Bank AG	commercial	8	A1	STA	A1	STA	-	baa2
Morgan Stanley Europe SE	commercial	7	-	-	Aa3	STA	-	-
Bausparkasse Mainz AG	commercial	3	A2	STA	-	-	-	baa2

Notes: "Co-operative banks" refers to member banks of Genossenschaftliche FinanzGruppe (G-Finanzgruppe), "public banks" refers to members of Sparkassen-Finanzgruppe (S-Finanzgruppe), "development banks" operate under a public mandate and are subject to certain competitive restrictions, "commercial banks" refers to all other entities listed. The table shows each bank's stand-alone credit strength as indicated by our Baseline Credit Assessment (BCA). Long-Term Bank Deposit, Senior Unsecured and Junior Senior Unsecured Ratings reflect a bank's stand-alone credit strength, plus affiliate and government support considerations, and our Advanced Loss Given Failure analysis; Siemens Bank GmbH and Volkswagen Financial Services AG are specialised finance institutions rated under our Finance Company methodology and - together with development banks - are excluded from ratio calculations in this report; The ratings of the two federal and the four regional development banks are backed ratings that benefit from a guarantee provided by the national or regional governments.
* Corporate Family Rating
** Hamburg Commercial Bank AG will transfer from public to commercial sector before 2022.
Source: Moody's Investors Service

Moody's related research

Sector and Macro Profiles:

» Banking System Profile Germany, March 2021

» Banking - Germany: Macro profile – Strong +, January 2021

Sector In-depth:

» Banks – Germany, Austria and Switzerland: H1 2021 earnings - Economic recovery drives profit uplift, October 2021

» Global Macro Outlook 2021-22 (August 2021 Update): Global growth rebound solidifies while risks broaden away from pandemic, August 2021

» Banking System Outlook Update - Germany: Outlook for German banks remains negative, March 2021

» Banks – Germany: Large cost cuts are needed to stay profitable, January 2021

» Banks – Germany: Lower for longer interest rates will exacerbate earnings pressures, October 2020

Rating Methodologies:

» Banks Methodology, July 2021

» Government-Related Issuers Methodology. February 2020

» Finance Companies Methodology, November 2019

Topic Pages:

» Coronavirus Credit Effects

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Definition of a sector outlook

Sector outlooks reflect our view of credit fundamentals in the banking sector over the next 12 to 18 months. Sector outlooks are distinct from rating outlooks, which, in addition to sector dynamics, also reflect issuers' specific characteristics and actions.

A sector outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of rating outlooks.

REPORT NUMBER 1305378

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