

OUTLOOK

26 March 2020

 Rate this Research

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Banking System Outlook Update - Germany

Growing strain of coronavirus disruption will increase pressure on German banks

Last November, we changed our [outlook on the German banking system](#) to negative from stable to signal our expectation that profitability and the overall creditworthiness of German banks would weaken over the next 12 to 18 months. We now expect the economic and market upheaval wrought by the coronavirus pandemic to further increase the strain on German banks' operating environment. We expect the severe economic dislocation to weaken loan performance and generate additional loan-loss provisioning needs for the banks. This will weaken asset quality and accelerate the deterioration in banking profitability we had previously anticipated.

2020 recession depresses operating environment. The longer that civil and economic life in Germany is disrupted by coronavirus outbreak, the greater headwinds German banks will experience from our forecast economic recession in 2020. Nevertheless, fiscal measures announced by the government will provide some support for the economy and for the banks' corporate borrowers and will keep Germany's low unemployment rate relatively stable. Persistently low interest rates remain a further and increasing challenge for German banks.

Problem loans will rise substantially. Despite our expectation of some forbearance by the banks and of ample government measures to support businesses, we expect the severe restrictions on everyday life in response to the pandemic to weaken the creditworthiness of corporates in numerous sectors, and to threaten the livelihoods of small and medium-sized businesses in particular.

Capital will remain strong. A temporary lowering of regulatory capital requirements will provide European banks with some flexibility in face of the harsh operating conditions, but we expect German banks to maintain their strong capital metrics. Ordinary mortgage and corporate lending growth will slow down, which will help to offset a rise in risk-weighted assets as credit facilities are more actively used by corporate borrowers and their credit strength declines.

Pressure on profitability will intensify. Lower interest rates and higher funding costs will tighten the squeeze on net interest results, while loan-loss charges will rise as economic conditions deteriorate. The banks will need to maintain spending on technological innovation to protect their competitiveness. Except for lower margin government-endorsed corporate liquidity facilities, corporate lending opportunities which had allowed German banks over the past years to offset interest margin pressure to some degree, will decline as the economy slows.

Strong access to deposits reduces banks' dependence on volatile funding markets. German banks benefit from access to a diversified set of funding tools, including a broad, but relatively costly retail deposit base and the domestic covered bond (Pfandbrief) market. This reduces the banks' dependence on confidence-sensitive unsecured funding sources and on the attractively priced long-term funding programs offered by the ECB. However, the latter provide a backstop in case of increased bank liquidity outflows due to increased reliance of corporates on bank facilities to cover their liquidity needs.

Our view on government support is unchanged. There is a moderate likelihood of government support for the largest, systemically important banks only. The German Government has so far focused its support measures on the companies and households most affected by the coronavirus-driven shutdown, with banks as conduits for some of this support.

Exhibit 1

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

Operating environment	Deteriorating	<ul style="list-style-type: none"> - GDP growth forecast for 2020 reduced with recession risks rising the longer civil and economic life in Germany are disrupted by the coronavirus outbreak = Household indebtedness and unemployment will stay relatively stable - Persistently low interest rates are increasingly challenging for German banks
Asset quality	Deteriorating	<ul style="list-style-type: none"> - Problem loans to rise because of the ongoing coronavirus disruption of economic and business activity = New lending will concentrate on households, drawings of committed corporate lines and government-supported liquidity provision to businesses = Announced fiscal measures will support employment and the liquidity of corporate borrowers
Capital	Stable	<ul style="list-style-type: none"> = Banks are unlikely to reduce capital cushions following a temporary lowering of regulatory buffer requirements = Weakening loan growth will limit growth in risk-weighted assets related to a downward drift in corporate borrower credit strength
Profitability and efficiency	Deteriorating	<ul style="list-style-type: none"> - Lower and flatter interest rate curves will sustain pressure on net interest margins, which will be harder to offset by the banks through sustained lending volume growth - Ongoing need for investment to catch up with technological innovation - Loan-loss provisioning costs will rise as a result of solvency problems of corporates in sectors most exposed to the coronavirus outbreak's economic effects
Funding and liquidity	Stable	<ul style="list-style-type: none"> + Banks have broad and diversified access to deposits, covered bond and senior unsecured funding. = In particular large banks are already compliant with MREL and will tend to replace junior senior maturities with senior preferred funding, which enables them to make use of their funding mix flexibility
Government support	Stable	<ul style="list-style-type: none"> = German banks operate under the EU's resolution regime BRRD, under which losses are primarily borne by equity and debtholders. Government support measures are primarily limited to situations of extreme economic hardship and dislocations, a scenario we would not anticipate for the German banking system, in light of the extensive fiscal policy measures adopted by the public sector authorities. We therefore continue to assume there is a moderate likelihood of support only for the senior debts and deposits of the banks that are systemically important or part of systemically important banking groups in the German financial system.

Source: Moody's Investors Service

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Exhibit 2

Aggregate key indicators for our rated German banks

Core Scorecard Ratios	2014	2015	2016	2017	2018
Problem Loans / Gross Loans	4.0%	3.4%	3.1%	2.6%	2.1%
Tangible Common Equity / Risk Weighted Assets	13.4%	14.3%	14.7%	16.1%	15.3%
Net Income / Tangible Assets	0.3%	0.1%	0.1%	0.2%	0.1%
Market Funds / Tangible Banking Assets	42.1%	39.9%	40.8%	38.8%	38.5%
Liquid Banking Assets / Tangible Banking Assets	38.1%	41.0%	40.6%	42.3%	39.2%
Additional Ratios					
Loan Loss Reserves / Problem Loans	49.7%	53.9%	55.3%	57.7%	56.8%
Tier 1 Ratio	13.6%	14.8%	15.0%	16.0%	15.2%
Tangible Common Equity / Total Assets	4.8%	4.9%	4.9%	5.2%	5.3%
PPI / Average RWA	1.5%	1.3%	1.2%	1.3%	1.0%
Cost / Income Ratio	71.6%	74.2%	76.6%	74.4%	79.0%

Notes: i. All ratios are asset-weighted averages for our rated banks and may be adjusted to reflect our analytical views. ii. We exclude some banks to avoid distortion and double-counting
 iii. Historic ratios may differ from previous outlooks, given changes in the sample of rated bank.

Source: Moody's Investors Service

Rating universe

We rate 45 German credit institutions, including development banks, specialised lenders and public-sector banking associations (Exhibit 3). German banks' Baseline Credit Assessments (BCAs) are distributed over an eight-notch range from a2 to ba3 (Exhibit 4). The median German bank BCA is baa2, one notch higher than the global median of baa3.

Exhibit 4

Rated German banking groups as of 19 March 2020 (sorted by total assets)

Rated Banks / Groups	Banking Sector	Total Assets		Deposit Rating	Outlook	Senior Unsecured /		Junior Senior Unsecured	BCA
		(Dec 2018, € billion)				Issuer Rating	Outlook		
Sparkassen-Finanzgruppe	public	2,178	-	-	Aa2	NEG	-	a2	
Deutsche Bank AG	commercial	1,348	A3	NEG	A3	NEG	Baa3	ba1	
DZ BANK AG	co-operative	519	Aa1	NEG	Aa1	NEG	A1	baa2	
Kreditanstalt fuer Wiederaufbau	development	486	Aaa	STA	Aaa	STA	-	-	
Commerzbank AG	commercial	462	A1	STA	A1	STA	Baa2	baa2	
UniCredit Bank AG	commercial	287	A2	STA	A2	STA	Baa3	baa2	
DB Privat- und Firmenkundenbank AG	commercial	276	A3	NEG	-	-	-	ba1	
Landesbank Baden-Wuerttemberg	public	241	Aa3	STA	Aa3	STA	A2	baa2	
Bayerische Landesbank	public	220	Aa3	STA	Aa3	STA	A2	baa2	
Sparkassenverband Baden-Wuerttemberg	public	197	-	-	Aa2	NEG	-	-	
ING-DiBa AG*	commercial	171	A2	STA	-	-	-	a2	
Landesbank Hessen-Thueringen GZ	public	163	Aa3	STA	Aa3	STA	A2	baa2	
Norddeutsche Landesbank GZ	public	154	A3	STA	A3	STA	Baa2	ba3	
NRW.BANK	development	149	-	-	Aa1	STA	-	-	
DekaBank Deutsche Girozentrale	public	100	Aa2	STA	Aa2	STA	A1	baa2	
Landwirtschaftliche Rentenbank	development	90	Aaa	STA	Aaa	STA	-	-	
Volkswagen Bank GmbH	commercial	83	A1	STA	A1	STA	A3	baa2	
Volkswagen Financial Services AG	commercial	80	-	-	A3	STA	-	-	
Deutsche Kreditbank AG	commercial	77	A1	STA	A1	STA	A2	baa2	
Bausparkasse Schwaebisch Hall AG	co-operative	72	Aa1	NEG	Aa1	NEG	-	baa2	
L-Bank	development	70	Aaa	STA	Aaa	STA	-	-	
Hamburg Commercial Bank AG	public/com.**	55	Baa2	STA	Baa2	STA	Baa3	ba2	
Deutsche Apotheker- und Aertztebank eG	co-operative	45	Aa1	STA	(P)Aa1	-	A2	baa1	
Landesbank Berlin AG	public	43	Aa2	STA	Aa2	STA	A2	baa2	
Santander Consumer Bank AG	commercial	43	A3	POS	A3	POS	-	baa1	
Aareal Bank AG	commercial	43	A3	STA	A3	STA	-	baa3	
Muenchener Hypothekenbank eG	co-operative	40	Aa3	NEG	Aa3	NEG	A2	ba1	
Berlin Hyp AG	public	27	Aa2	STA	Aa2	STA	A2	ba1	
KfW IPEX-Bank GmbH	commercial	27	Aa2	STA	-	-	-	a3	
Sparkasse KoelnBonn	public	27	A1	STA	(P)A1	-	Baa1	baa2	
Kreissparkasse Koeln	public	26	Aa3	NEG	Aa3	NEG	A3	a3	
UBS Europe SE	commercial	25	Aa3	STA	Aa3	STA	-	baa1	
Bayerische Landesbodenkreditanstalt	development	22	Aaa***	STA	Aaa***	STA	Aaa***	-	
LfA Foerderbank Bayern	development	21	Aaa	STA	Aaa	STA	-	-	
J.P. Morgan AG	commercial	21	Aa1	STA	Aa3	STA	-	a2	
Deutsche Hypothekenbank (Actien-Gesellschaft)	public	21	A3	STA	A3	STA	Baa2	ba3	
Oldenburgische Landesbank AG	commercial	19	Baa2	STA	Baa2	STA	-	baa3	
Landesbank Saar	public	15	A1	STA	A1	STA	-	ba1	
Debeka Bausparkasse AG	commercial	9	Baa3	NEG	-	-	-	ba1	
Siemens Bank GmbH	commercial	7	-	-	A1	STA	-	-	
Citigroup Global Markets Europe AG	commercial	6	-	-	A1	STA	-	-	
Standard Chartered Bank AG	commercial	5	A1	STA	A1	STA	-	baa2	
Morgan Stanley Bank AG	commercial	3	A1	RUR	A1	RUR	-	baa2	
Bausparkasse Mainz AG	commercial	2	A2	NEG	-	-	-	baa2	
Morgan Stanley Europe SE	commercial	1	-	-	A1	RUR	-	-	

Notes: i. "Co-operative banks" refers to member banks of Bundesverband der deutschen Volksbanken and Raiffeisenbanken (BVR), "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; ii. S-Finanzgruppe has a Corporate Family Rating; iii. 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. iv. 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.

* ING-DiBa AG's ratings are based on the financials of ING Holding Deutschland GmbH

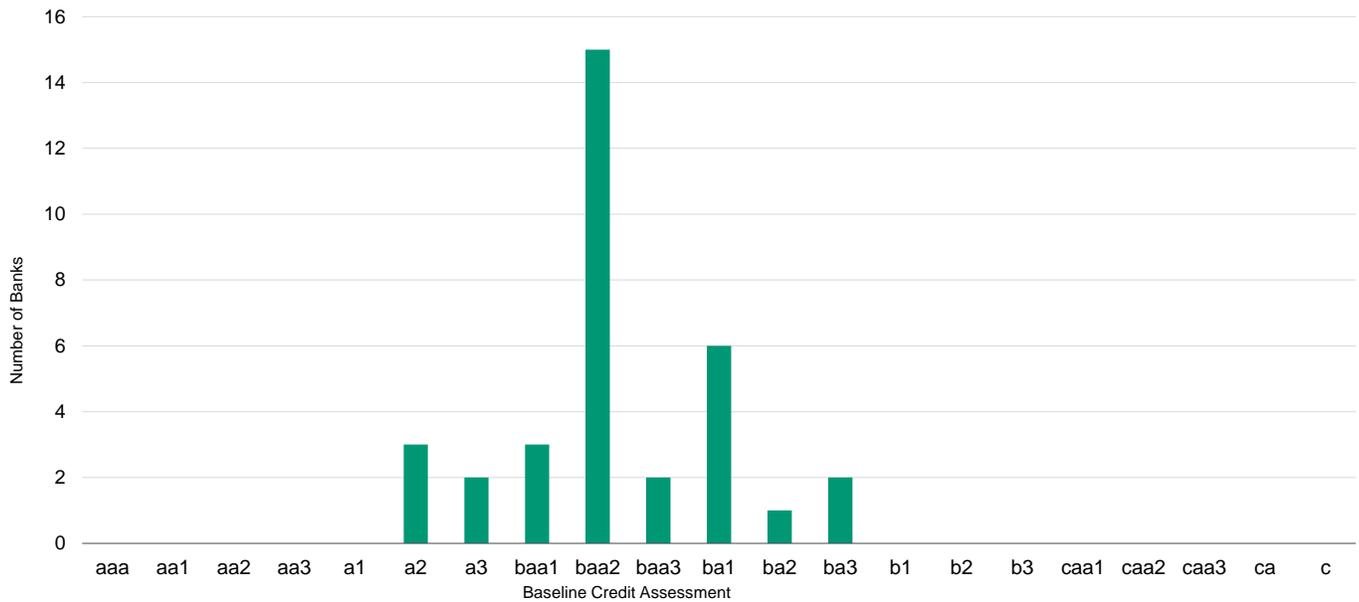
** Hamburg Commercial Bank AG will transfer from public to commercial sector before 2022

*** The deposit and issuer ratings of Bayerische Landesbodenkreditanstalt are BACKED deposit, issuer and junior senior unsecured ratings that benefit from a guarantee by the Free State of Bavaria (Aaa stable)

Source: Moody's Investors Service

Exhibit 5

German bank BCA distribution as of 19 March 2020



Source: Moody's Investors Service

Moody's related research

Sector and Macro Profiles:

- » [Banking System Outlook - Germany: Slowing economy and rising profitability challenges drive our negative outlook](#), November 2019
- » [Germany Macro Profile: Strong+](#), October 2019
- » [Banking System Profile Germany](#), December 2018

Sector In-depth:

- » [Financial Institutions – Global: Coronavirus, oil shock hurt asset quality; monetary response reduces profitability](#), March 2020
- » [Coronavirus – Germany: Germany's comprehensive support package will soften the coronavirus' negative effect on the economy](#), March 2020
- » [Banking – Europe: ECB measures will provide limited economic offset to coronavirus weakness](#), March 2020
- » [Government of Germany: Germany's economic policy measures are expected to mitigate the coronavirus' contraction impact](#), March 2020
- » [Banks – Europe: Coronavirus outbreak adds to late-cycle risks for European banks](#), March 2020
- » [Global Macro Outlook 2020-21 \(March 2020 Update\) – Coronavirus will hurt economic growth in many countries through first half of 2020](#), March 2020

Rating Methodologies:

- » [Request for Comment – Banks: Proposed Methodology Update](#) - March 2020
- » [Banks Methodology](#), November 2019
- » [Government-Related Issuers Methodology](#), February 2020
- » [Finance Companies Methodology](#), November 2019

Topic Pages:

- » [Coronavirus Credit Effects](#)
- » [ESG Impact](#)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

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Banking system outlooks represent our forward-looking assessment of fundamental credit conditions that will affect the creditworthiness of banks in a given system over the next 12-18 months. As such, banking system outlooks provide our view of how the operating environment for banks, including macroeconomic, competitive and regulatory trends, will affect asset quality, capital, funding, liquidity and profitability. Banking system outlooks also consider our forward-looking view of the systemic support environment for bank creditors.

Since banking system outlooks represent our forward-looking view on credit conditions that factor into our bank ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average.

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