

Germany

The German economy is moving in a very challenging environment. The risks and stress factors have increased further in the course of 2022. Above all, the energy crisis that has developed as a result of the Russian war of aggression on Ukraine and the extraordinarily high inflation rate are fuelling uncertainty. Added to this are the major challenges posed by the transformation of the economy towards sustainability and a readjustment of cross-border production and supply chains to strengthen resilience to crises.

The ECB has reacted to the rising inflation rates. In July 2022, it ended the eight-year phase of the negative interest rate policy. Further, particularly strong interest rate steps followed in September and October 2022.

German banks continue to be quite robust in this very difficult macroeconomic environment. Taken in itself, the end of the negative interest rate policy improves earnings prospects. However, the strong and rapid increase in capital and money market interest rates is associated with certain risks for the value of assets. In addition, significantly increased costs - especially material costs driven by high inflation - are weighing on banks, and the risk of loan value adjustments is rising with the deteriorating economic outlook.

Even if, from today's perspective, GDP in Germany is likely to decline somewhat in 2023 - the European Commission is assuming an annual average decline of 0.6% - the situation of German banks should remain robust. The equity base has been expanded strongly in recent years and provides a solid buffer. In the lending business, lending to companies and the self-employed has with €1,038 billion in 2021 increased compared to the previous year (+3.4%). The high interest rates and the weak economic development are likely to dampen demand for real estate and "classic" corporate loans in the coming months. However, this is offset by a growing need for financing for the climate-neutral restructuring of the economy and for infrastructure projects.

Germany's banking system comprises three pillars — private commercial banks, public-sector banks, and cooperative banks — distinguished by the legal form and ownership structure.

The private-owned commercial banks represent the largest segment by assets, accounting for around 40% of total assets in the banking system. An important feature of the private banks is that they compete keenly not only with banks in other sectors of the industry, but also among themselves. The private banks play a key role for the German export economy, they are involved in 88% of German exports and maintain almost three quarters of the German banking industry's foreign network.

The public banking sector comprises savings banks (Sparkassen), Landesbanken, and DekaBank, which acts as the central asset manager of the Savings Banks Finance Group, representing just over a quarter of total banks' assets. There are currently 371 savings banks. They are normally organised as public law corporations with local governments as their guarantors/owners. Their business is limited to the area controlled by their local government owners. Other than this regional focus, their business does not differ in any way from that of the private commercial banks. As a result of the so-called regional principle, savings banks do not compete with one another.

Landesbanken were originally designed to act as central banks for the savings banks. In recent years, however, they have been increasingly involved in wholesale funding, investment banking, and international business activities, thus directly competing with commercial banks. The six Landesbanken at present are owned by the federal states and the regional associations of the savings banks.

The cooperative sector consists of 773 cooperative banks (Volks- und Raiffeisenbanken) and one central cooperative bank (DZ Bank AG). It accounts for 53% of all institutions by number and around 12% of total

bank assets. The cooperative banks are owned by their members, who are usually their depositors and borrowers as well. By virtue of their legal form, cooperative banks have a mandate to support their members, who represent about half of their customers. But cooperative banks also provide banking services to the general public. Like the savings banks, cooperative banks have a regional focus and are subject to the regional principle.

The number of banks in Germany has dropped sharply in recent years, and by 60% since 1995. Consolidation to achieve economies of scale has taken place largely within the existing pillars. In most cases in the savings bank and cooperative sectors (contrary to mergers in the private sector), consolidation has been the result of stress rather than proactive business considerations.