Germany

The German economy is moving in a very challenging environment. The risks and challenges have remained high in the course of 2023. Uncertainty is dampening companies' appetite to invest and is apparently also weighing on consumer confidence. 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, as well as demographic change, which is leading to a shrinking labour force.

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 interest rate hikes followed until September 2023, when the deposit facility was raised to 4.0%.

German banks are proving to be very robust in this very difficult macroeconomic environment. Taken in itself, the end of the negative interest rate policy improves earnings prospects. However, the sharp and rapid rise in capital and money market interest rates was also associated with certain risks for the value of assets. In addition, the correction in property prices and the significant fall in demand for property loans are weighing on the banks' business situation.

Even if GDP in Germany is likely to stagnate in 2024 - from today's perspective and the ECB has already initiated the first steps to cut interest rates, the earnings situation of German banks should remain fairly stable. The equity base has been expanded strongly in recent years and provides a solid buffer. The refinancing side via customer deposits also remains strong.

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. Private banks play a key role in the German export economy. Through their subsidiaries and branches abroad, private banks 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 around 360 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 nearly 700 cooperative banks (Volks- und Raiffeisenbanken) and one central cooperative bank (DZ Bank AG). It accounts for slightly more than 50% 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 more than 50% since 2001. 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.

Contributor: Association of German Banks - Ute Schmaltz ute.schmaltz@bdb.de