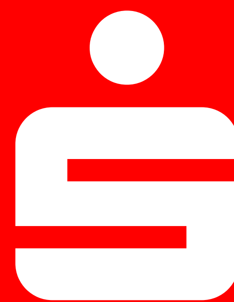
Finanzgruppe
Deutscher Sparkassen-
und Giroverband

Standpunkte
der Chefvolkswirte



German Banking Market: Robust in the Corona Crisis

October 2020

Authors
Uwe Burkert - LBBW
Uwe Dürkop - Berliner Sparkasse
Jochen Intelmann - Haspa
Dr. Ulrich Kater - DekaBank
Christian Lips - NORD/LB
Dr. Jürgen Michels - BayernLB
Dr. Reinhold Rickes - DSGV
Dr. Gertrud Traud - Helaba
Prof. Dr. Carsten Wesselmann
- Kreissparkasse Köln

Coordinator:
Dr. Sonja Scheffler
sonja.scheffler@dsgv.de

The Covid-19 crisis is taking a serious toll on the German economy, although the extent and duration of the slump are still difficult to estimate. Forecast scenarios likewise vary markedly regarding the subsequent recovery phase. Against this background, it is important to take a look at the financing of German SMEs. The Chief Economists of the Savings Bank Finance Group have therefore analysed the crisis resilience of the German banking market and especially of the Savings Bank Finance Group itself.

- **Savings banks and Landesbanken are amongst the largest financiers of small and medium-sized companies in Germany. Savings banks in particular have ramped up their equity capital in recent years and have thus become more crisis-resistant.**
- **Credit risks are destined to increase going forward due to the coronavirus crisis. However, the internal corona stress test conducted by Bafin and the German Bundesbank shows that small and medium-sized credit institutions are largely stress-resistant.**
- **The regulatory relief measures adopted in the face of the Corona crisis are very welcome, but need to be thought through further for the future.**

Savings banks and Landesbanken are the SMEs’ financiers

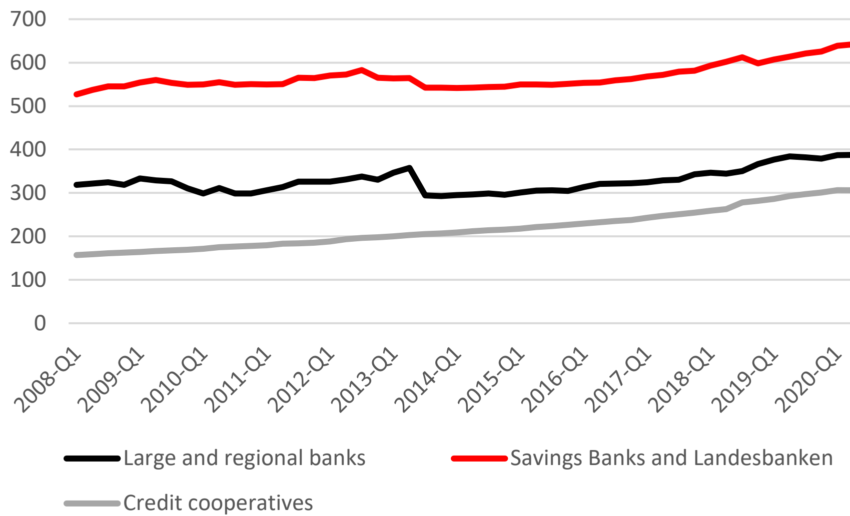
The public banking sector accounts for a significant share of the aggregate balance sheet total of the overall German banking landscape. About one-quarter of the balance sheet total in the Federal Republic is accounted for by the savings banks and Landesbanken sector. With around 380 institutions, over 13,000 branches and almost 205,000 employees, savings banks have a palpable presence throughout Germany. The Savings Bank Group’s regional principle ensures a nationwide supply of loans. Proximity to the customer creates a special common bond even in economically difficult phases.

Savings banks and Landesbanken are amongst the largest financiers of small and medium-sized companies in Germany. Around two-fifths of all loans to companies and the self-employed are attributable to the Sparkassen-Finanzgruppe. This also applies to loans refinanced by the development banks: here too, the Sparkassen-Finanzgruppe's market share is around 40 percent, making it the No. 1 in the market.

Significantly more than 40 percent of KfW's targeted coronavirus aid has been extended by the savings banks. In this context, neither a pro-rata nor a 100 percent release from liability within the scope of a KfW loan is a subsidy for the customer’s house bank, because it is the customer who is the beneficiary. Thanks above all to a greatly simplified lending process and, where appropriate, the assumption of the risk assessment for the house bank by KfW, the development loans pursuant to the KfW special programs have been granted very quickly. House banks provide their customers with comprehensive advice when they apply for a development loan and then look after their interests in keeping with the terms of the contract over the loan term of up to ten years. In this way, the public sector makes a significant contribution to ensuring that the government’s coronavirus relief loans end up with the companies for whom they are envisaged

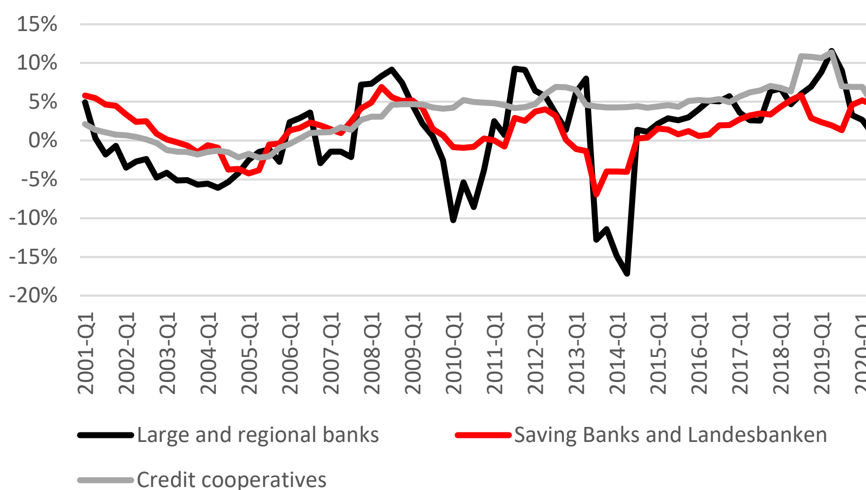
Savings banks and Landesbanken are supporting companies and the self-employed dur-

In addition, the Federal Government has imparted important stimuli to help companies and thus also the underlying economic structure weather the crisis with the Economic Stabilisation Fund (WSF) and the aid mustered for micro, small and medium-sized enterprises. In the first weeks of the crisis, the Savings Banks held around 1.4 million advisory meetings with commercial customers alone. In numerous cases, interest and redemption payments were suspended. Many of the moratoriums granted by the savings banks and Landesbanken also go far beyond the legal requirements in terms of their duration and allow for longer suspensions of repayments.



Source: Deutsche Bundesbank, LBBW Research.

The public banking sector grants nearly as many business loans as credit cooperatives and (large) private banks combined. The share commanded by savings banks alone is around 30 percent. By contrast, Germany's big "High Street" private banks only account for a share of (just under) 12 percent.



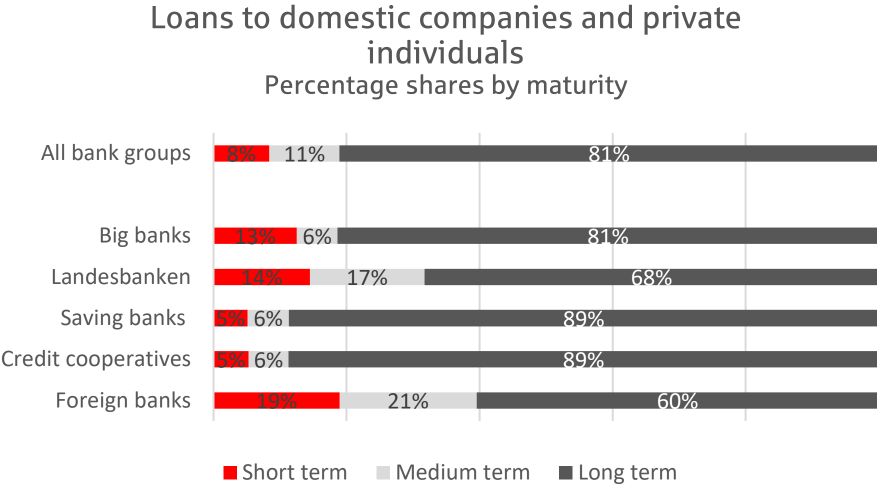
Source: Deutsche Bundesbank, LBBW Research.

Moreover, a comparison between the two banking groups reveals that the slump in lending growth by the public sector in the wake of the financial crisis in the years 2009 to 2011 has been less severe in the

savings-bank domain. Since 2001, the growth curve in this comparison has also been less volatile, which indicates relatively steady lending across the various economic cycles.

Savings banks and Landes-banken see themselves as long-term companions of their cus-

Public-sector banking institutions see their role as advising and standing by their customers for the long haul. This can be gauged by a glance at loans to domestic companies and private individuals. Not only does the savings bank sector have the largest volume of customer loans to the non-bank sector in absolute terms (around EUR 860 billion), but the maturity profile also testifies to a close relationship with the borrowers concerned.



Source: Deutsche Bundesbank, LBBW Research (cut-off date: 4/20)

The proportion of long-term loans extended by savings banks comes to around 89 percent, while foreign banks or Germany's big private banks, for example, show a higher proportion of short-term loans. Divergent customer structures also play a role here. As a customer of a "larger" bank, a DAX company can finance itself via bonds, but may rather need a short-term classic loan to bridge the liquidity gap. Nevertheless, we believe that this makes it manifest that the savings bank sector sees its role as a "loyal" companion to its customers.

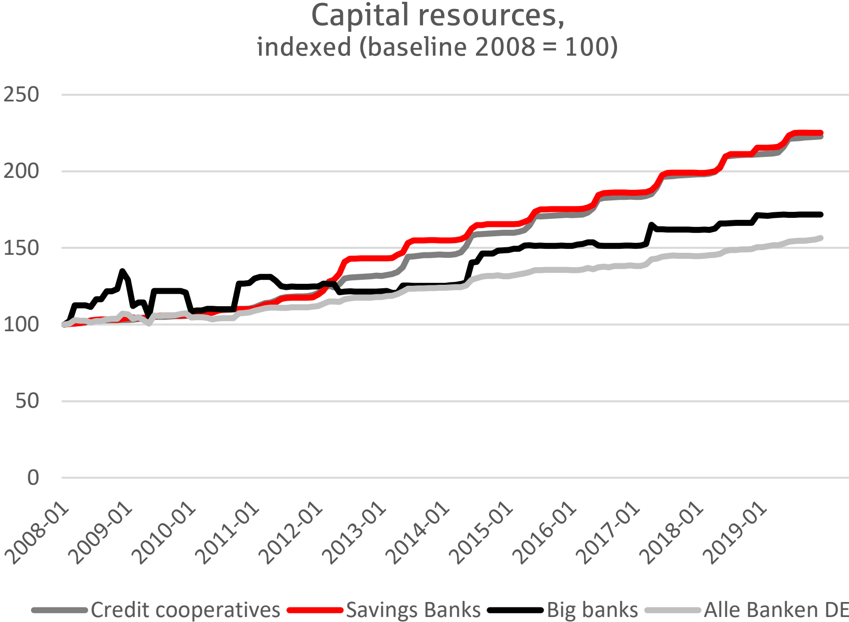
Pay attention to risk provisioning - maintain a proper balance

But financial support for the economy is also fraught with risks. The chief economists of the Sparkassen-Finanzgruppe are forecasting a GDP slump of minus 6.4 percent for Germany in 2020. However, according to a recent survey, three quarters of the corporate customer advisors at the savings banks expect that less than two percent of their SME corporate customers will have to file for insolvency in the next six months - regardless of the suspended obligation to file for insolvency. Nevertheless, loan loss provisions at all banks will rise sharply, with a wide range of factors to be assumed. In the first quarter, there was an average increase by a factor of 6 across Europe, driven mainly by general loan loss provisions. Payment moratoria are spreading the deterioration

in asset quality. German banks have an above-average low ratio of non-performing loans (NPL ratio). A gradual reversal of this trend is likely to set in over the coming months. All this will put a heavy strain on profits and equity. It is essential for banks to maintain a balance between "money-locks on" and "risk awareness".

Lending is only possible with a sufficient capital buffer

Compared to the German banking sector as a whole, the country's Savings Banks have increased their equity capital disproportionately since 2008.



Source: Deutsche Bundesbank, LBBW Research, capital including open reserves, profit-participation capital (Genussrechte) und funds set aside for general bank-related risks

The volume of equity shown on the balance sheet today is around twice as high as at the beginning of the financial crisis in 2008/2009. From the point of view of Basel IV too, studies by the Bundesbank (Deutsche Bundesbank: Statistical Annex to the Basel III Monitoring for German Institutions, dated April 2020) show that the "smaller" institutions are better positioned in relative terms. While the core capital ratio of Germany's big private banks will fall from 14.5 percent to 9.6 percent by 2028 if the Basel III reform package is finally implemented without countermeasures by the banks, the ratio for the "smaller" institutions will remain in the double-digit range at 13.3 percent (minus 5 percentage points).

The current survey on lending business in Germany (Deutsche Bundesbank Bank Lending Survey July 2020) reflects this balancing act. In the current survey on lending business, German banks are expecting

an increase in net demand for loans over the coming three-month period as well. On the other hand, they are simultaneously planning to tighten lending guidelines for almost all sectors of the economy. Credit risks are accordingly set to increase - the financial institutions are facing a tightrope walk.

Small and medium-sized credit institutions are stress-resistant

The internal corona stress test conducted by Bafin and Deutsche Bundesbank shows that small and medium-sized credit institutions are largely stress-resistant. The national supervisory authority and the Bundesbank have carried out a special coronavirus-induced stress test for the country's approximately 1,400 "less important institutions". This stress test was only carried out internally by the supervisory authority. It shows that the credit insitutions would be sufficiently capitalised on average even in the event of a severe slump in GDP, although equity capital would certainly take a sigificant hit. It remains to be seen whether this would mean that, on average, the credit institutions might fail to meet the new, reduced SREP requirements. However, the simulations did not take into account possible countermeasures and the positive effects of government aid programs.

Small and medium-sized credit institutions prove to be sufficiently capitalised

The results of the "LSI Stress Test" published in September last year, which the Bundesbank and BaFin used to examine the resilience of small and medium-sized banks and savings banks, support the previous assessment of "extensive stress resistance". The test simulated a severe economic downturn over a three-year horizon. In this context, the phase of low interest rates continues to pose a considerable challenge and leads to ongoing pressure on margins. In the stress scenario, the CET1 ratio falls on average by 3.5 percentage points to 13 percent. Nevertheless, Germany's banking institutions would still, on average, remain "solidly capitalised" to ride such a crisis, in the opinion of the supervisory authority.

Following through on the new regulatory relief measures

The supervisory simplifications resolved in the light of the Corona crisis are very welcome. According to the ESRB, policymakers and supervisory authorities decided early on - starting as early as the spring - some 900 individual measures to help banks cushion the economic impact of Covid-19. One of the aims is to relieve the banks' capital burden in order to boost the supply of credit to the real economy. Among the most important decisions are the postponement of the G-SiFi Leverage Ratio Buffer Add-on and the partial replenishment of the Pillar 2 requirement (P2R) with subordinated capital components. In addition, the reduction

Corona-related first aid measures are important...

of the countercyclical capital buffer and systemic risk buffer was initiated in many countries. In addition, banks were granted flexibility in the transition to IFRS9 and the treatment of state guarantees and moratoriums. Furthermore, in case of doubt, the supervisory authorities currently tolerate a temporary shortfall of the LCR ratio (<100%) and the combined buffer requirement. Greater flexibility in the timeframe for setting up the MREL target ratio is also planned, as is the postponement of the application of the Basel III Final Package by one year to January 2023. In addition, temporary relief for credit institutions in the calculation of the leverage ratio will follow by excluding assets at central banks. In addition to the European Commission, the facilitations therefore also fall within the scope of the ECB Banking Supervision (SSM), EU Bank Resolution (SRB) and the Basel Committee and - for Germany - the National Financial Stability Committee.

... but need to be followed through in future

Over and above these important corona-related first aid measures, however, it is also important to look to the future. Some of the measures now decided upon make use of the leeway provided by the current regulatory framework in the form of variable buffer requirements, which allow banks relief in times of crisis. Before the next crisis strikes, these buffers should be accordingly replenished. The supervisory authorities would therefore be well advised to discuss an unwind of the temporary easing measures in due course - but in doing so, they should proceed cautiously in view of the expected second- and third-round effects emanating from the current crisis. It still seems far too early to set a timetable: since the recovery period for the real economy, but also for bank balance sheets, is fraught with a great deal of uncertainty, a return to supervisory normality is not conceivable for quite some time to come. Due to the foreseeable weakening of bank balance sheets, the coronavirus crisis has also shifted the starting position for the (planned) tightening of regulatory requirements. Caution is therefore called for, especially with regard to the output floor under Basel IV. It also remains necessary to avoid abrupt transitions and to ensure strict proportionality in order to minimise the regulatory burden. In addition, burdens deriving from payments into the EU resolution fund should be reviewed in order to strengthen the equity base of banks.

Final conclusion

The central question in the age of corona is therefore not whether or not a burden will fall on the credit institutions, but rather how onerous this burden will prove. Attempts to quantify the effective aggregate impact of the coronavirus pandemic are subject to an extremely high degree of uncertainty. The actual burden will inevitably depend very much on the structure of individual credit portfolios.

Another decisive factor is the speed and sustainability with which companies, and thus the underlying economic structure as a whole, come to terms with change. The Covid-19 crisis is, first and foremost, a pronounced economic shock. It also more clearly acccentuates the need for structural action that already exists. Depending on the duration and depth of the change, the crisis will also generate a need for further structural action. The Savings Banks Finance Group stands by its customers in this respect, proving not only reliable companions in times of crisis, but also successful guides in times of change. The 200-year history of Germany's savings banks furnishes impressive proof of this. Last year, the Savings Bank Group racked up an aggregate profit after tax of EUR 1.8 billion. Nationwide, the savings banks topped up their contingency reserves for difficult times to EUR 4.0 billion (cut-off date: 2019). In keeping with this, the Savings Banks Finance Group feels well equipped to take on the challenges the future will bring on its customers' behalf.

Disclaimer

The present position paper by the Chief Economists does not necessarily correspond to the stance of the **DekaBank** or to the stance of the respective **Landesbanken** and Savings Banks or of the DSGV.

Published by
Deutscher Sparkassen- und Giroverband
Abteilung Volkswirtschaft, Finanzmärkte
und Wirtschaftspolitik
Charlottenstraße 47 10117 Berlin
Telefon: 030 20225-5303
DSGV-Volkswirtschaft@DSGV.de
www.DSGV.de

Editorial Deadline
1.October 2020

Layout
Franz Metz, Berlin

Photography
pixabay/Free Photos

Management
Pia Jankowski – DSGV
Director
Head of Economics, Financial Markets and Economic Policy Pia.Jankowski@DSGV.DE

Dr. Reinhold Rickes – DSGV
Head of Economics

Reinhold.Rickes@DSGV.DE

Note
You can access this document at
https://www.dsgv.de/positionen.html#standpunkte

ISSN
2509-3851