

Germany outlook report

Second quarter of 2023



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Management Solutions

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The quarterly report of Germany aims to provide a comprehensive and executive view of the main indicators of the banking sector, along with the macroeconomic situation at the end of the quarter.

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1. International overview

In 2Q23, the global economy slowed down because of persistent inflation - especially core inflation - and the resulting tightening of monetary policy by major central banks. Growth is expected to be subdued in 2023 and inflation to reach target levels by the end of 2025.

Macroeconomic outlook

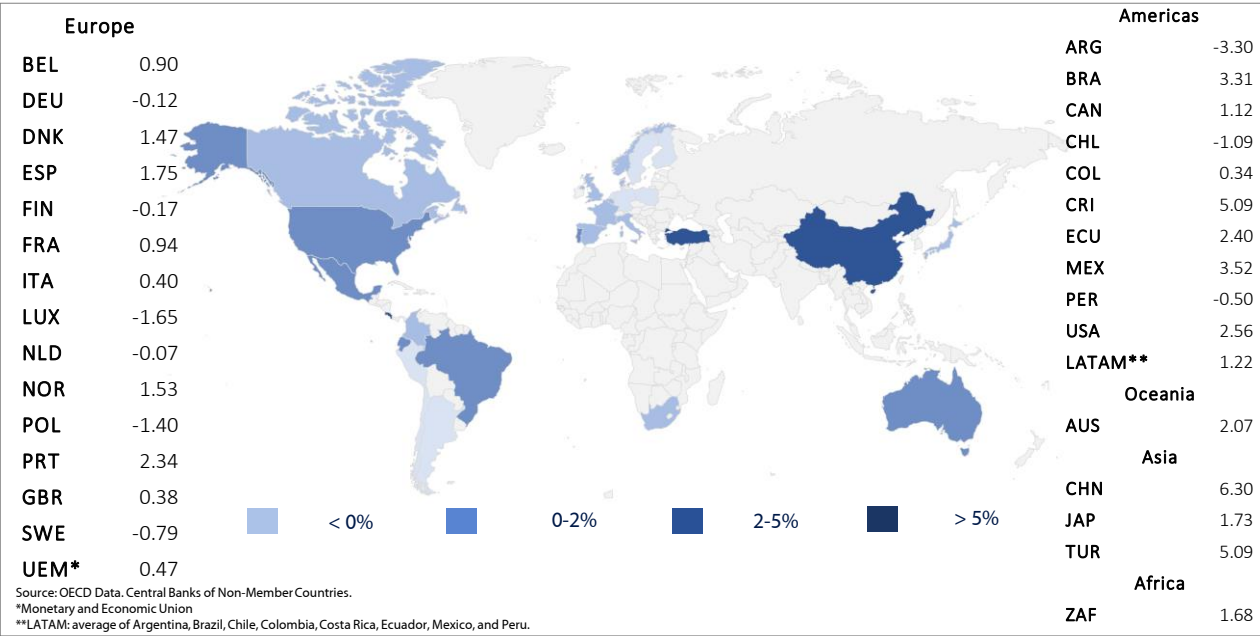
- ▶ During 2Q23, the euro zone registered growth of 0.47%, compared to 1.30% in 1Q23, consolidating the economic stagnation of the area. Of note is the case of Germany, which recorded a decline for the second consecutive quarter and high inflation. The euro zone's average CPI fell to 6.20%, almost 2 p.p. less than in 1Q23 (8.01%), although concerns remain about the persistence of core inflation, while the average unemployment rate declined slightly to 6.4%.
- ▶ Of note in the Americas was the slowdown in the Latam¹ region compared to the previous quarter (1.22% vs. 2.12%), with countries with negative growth rates such as Argentina, Chile and Peru. In contrast, the US continued to stand out, consolidating its growth with a rate of 2.56% (1.62% in 1Q23). Inflation in the US fell to 3.97%, while the Latam¹ average was 20.31% (excluding Argentina (113%), the average was 7.07%). On the continent, unemployment rates were generally stable compared to the previous quarter's reference values.
- ▶ In the Asian region, the reopening of China after the removal of Covid-19 restrictions strengthened economic growth in the region. The growth rate in China was 6.30% (4.50% in 1Q23) and 1.73% in Japan (1.79% in 1Q23).
- ▶ Australia recorded growth of 2.07% (2.27% in 1Q23), continuing its economic slowdown, with a relatively stable unemployment rate of around 3.6% and falling but still high inflation, which closed the second quarter of the year at 6.03%.
- ▶ South Africa, on the other hand, recovered from the decline in its growth rate to 1.68% (compared to 0.18% in the previous quarter), with inflation down at 6.45% and unemployment high at almost 35%.
- ▶ The IMF expects global growth to slow from the recorded 3.5% in 2022 to the 3.0% estimated by the organisation for both 2023 and 2024, in the face of the economic drag from central banks continuing to raise policy rates to combat inflation. Global inflation is projected to fall from 8.7% in 2022 to 6.8% in 2023 and 5.2% in 2024, while core inflation is expected to decline more gradually. Inflation is expected to reach target levels by the end of 2025.
- ▶ ECLAC expects the region's economies to maintain low levels of growth this year and next, affected by a negative global and very complex regional economic outlook, estimating regional average GDP growth of 1.7% in 2023, while for 2024 it projects a slight decline to 1.5%. By sub-region, South America is estimated to grow by 1.2%, Central America and Mexico by 3%.

Other indicators and main risks

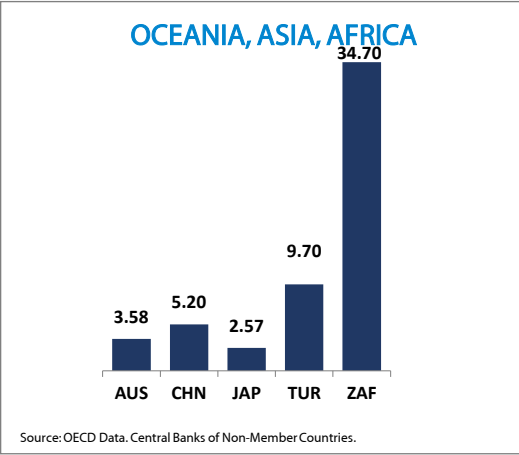
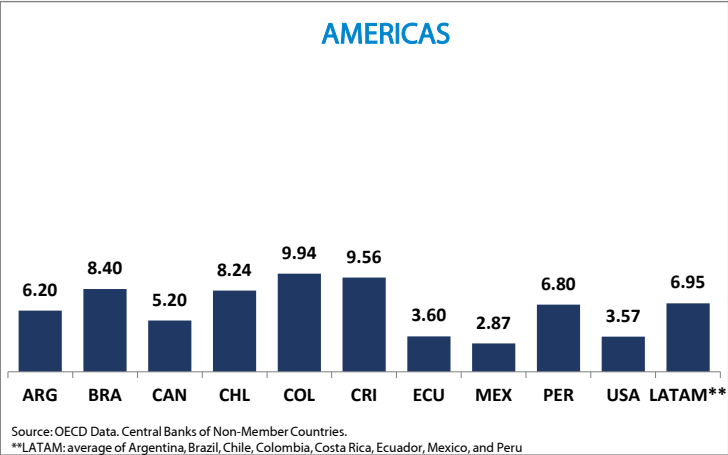
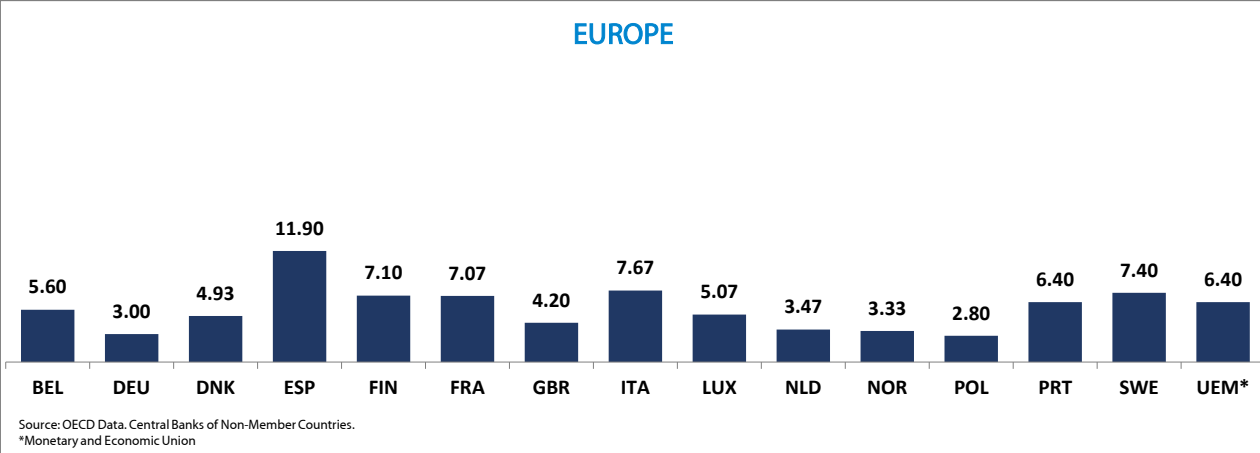
- ▶ The euro consolidated its recovery against the dollar from its decline in 2022. The dollar has become less attractive against the euro because of the interest rate hike cycle of both central banks, the outlook for economic recovery in both regions (expected to be slower in the US) and the government's plan to reduce the US fiscal deficit by raising taxes.
- ▶ The main Latin American currencies also strengthened against the dollar, except for the Argentine peso, whose exchange rate rose from 1Q23 to 239.33 pesos per dollar, a consequence of the region's runaway inflation.
- ▶ The IMF warns that global debt reached 238% of world GDP (+9 p.p. since 2019) and urges governments to take urgent action to reduce long-term debt vulnerabilities and offers specific recommendations for public and private sector debt.

¹ The average for Latam countries is composed from macroeconomic data for the countries of Argentina, Brazil, Chile, Colombia, Costa Rica, Ecuador, Mexico and Peru.

GDP (% , year-on-year growth)

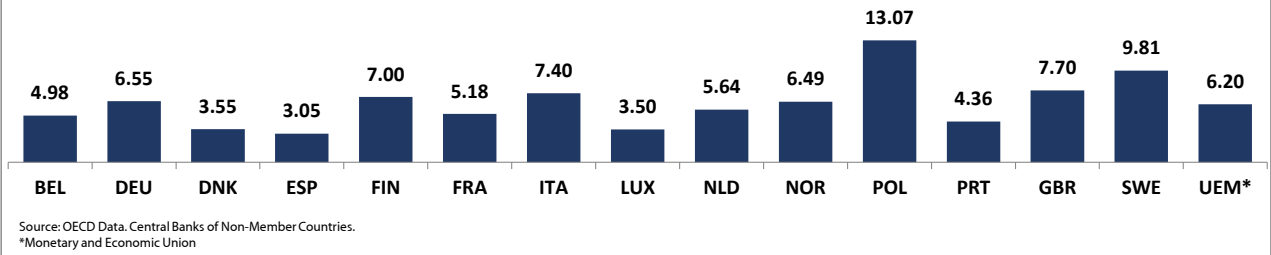


Unemployment rate (%)

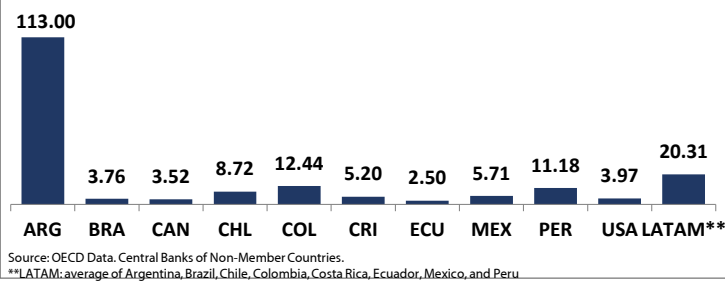


Inflation rate (%)

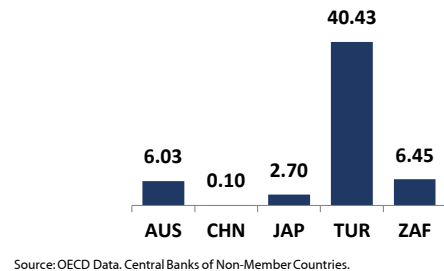
EUROPE



AMERICAS



OCEANIA, ASIA, AFRICA



Global Ratings and Exchange Rates

LONG-TERM RATES 2Q23

	MOODY'S	S&P	Fitch
EUROPE			
DEU	Aaa	AAA	AAA
BEL	Aa3	AA	AA-
DNK	Aaa	AAA	AAA
ESP	Baa1	A	A-
FIN	Aa1	AA+	AA+
FRA	Aa2	AA	AA-
ITA	Baa3	BBB	BBB
LUX	Aaa	AAA	AAA
NLD	Aaa	AAA	AAA
NOR	Aaa	AAA	AAA
POL	A2	A-	A-
PRT	Baa2	BBB+	BBB+
GBR	Aa3	AA	AA-
SWE	Aaa	AAA	AAA
AFRICA			
ZAF	Ba2	BB-	BB-
OCEANIA			
AUS	Aaa	AAA	AAA
ASIA			
CHN	A1	A+	A+
JAP	A1	A+	A
TUR	B3	B	B
AMERICAS			
ARG	Ca	CCC-	C
BRA	Ba2	BB-	BB-
CAN	Aaa	AAA	AA+
CHL	A2	A	A-
COL	Baa2	BB+	BB+
CRI	B2	B+	BB-
ECU	Caa3	B-	B-
MEX	Baa2	BBB	BBB-
PER	Baa1	BBB	BBB
USA	Aaa	AA+	AAA

▲ Increased from 1Q23

▼ Decreased from 1Q23

Source: Investing.

EXCHANGE RATES 2Q23 (\$*)

EUROPE	2Q22	3Q22	4Q22	1Q23	2Q23	2023
EUR	0.94	1.00	0.97	0.93	0.92	0.92
DKK	7.10	7.59	6.95	6.91	6.85	6.86
NOK	9.85	10.91	9.80	10.27	10.81	10.56
SEK	10.24	11.09	10.45	0.10	10.63	10.35
GBP	1.22	1.12	1.21	0.82	0.80	0.81
PLN	4.48	4.96	4.38	4.36	4.15	4.23
AMERICAS	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ARG	117.95	135.79	176.71	197.70	239.22	219.09
BRL	5.23	5.41	5.29	5.10	4.94	5.00
CLP	928.98	965.90	849.41	805.80	805.20	796.01
COP	4,161.04	4,597.52	4,849.39	4,725.30	4,438.83	4,611.09
PER	3.79	3.99	3.80	3.79	3.66	3.71
MXN	20.13	20.10	19.50	18.38	17.59	17.88
AFRICA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
ZAR	16.27	18.15	17.00	17.76	18.94	18.82
OCEANIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
AUS	1.45	1.56	1.47	1.47	1.51	1.49
ASIA	2Q22	3Q22	4Q22	1Q23	2Q23	2023
RMB	6.70	7.11	6.90	6.85	7.09	6.93
TRY	16.33	18.21	18.62	18.94	22.09	19.40

Source: Investing, OECD projections, June 2023.

*The base currency used is the US dollar against each local currency quoted.

2. Macroeconomic view

The German economy is going through a period of stagflation, although it is expected to pick up by 2024 (1.28%), with inflation slowing to 3%. The unemployment rate is stable at around 3%, while employment growth is slowing down.

Main Macroeconomic Indicators (%)

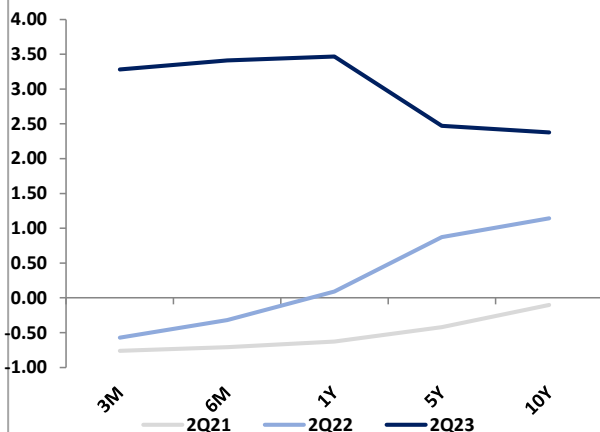
ACTIVITY	2Q22	3Q22	4Q22	1Q23	2Q23	Var. p.p.1Q23	Var. p.p.2Q22	2023	2024
GDP	1.67	1.35	0.84	-0.52	-0.12	0.40	-1.79	0.00	1.28
DOMESTIC DEMAND	4.44	2.05	0.86	-2.70	-1.38	1.31	-5.82	-0.78	1.27
HOUSEHOLD CONSUMPTION	6.54	2.80	1.11	-1.51	-0.53	0.98	-7.07	-1.40	1.56
PUBLIC CONSUMPTION	-0.04	0.34	0.26	-5.43	-3.13	2.29	-3.09	-3.89	1.40
CAPITAL FORMATION	0.47	7.90	3.96	5.94	2.94	-3.00	2.47	0.83	0.63
EXTERNAL DEMAND									
EXPORTS	3.38	5.63	1.17	1.24	-0.70	-1.94	-4.08	1.06	2.40
IMPORTS	7.79	10.92	2.72	1.40	-1.32	-2.72	-9.11	-0.45	2.49
INFLATION									
CPI	6.66	7.40	8.58	8.24	6.55	-1.70	-0.11	6.29	3.04
LABOUR MARKET									
UNEMPLOYMENT RATE	3.00	3.10	3.03	2.87	3.00	0.13	0.00	2.86	2.78
EMPLOYMENT*	1.48	1.09	1.04	0.97	0.78	-0.19	-0.70	1.54	0.50

*The employment variable represents the year-on-year change in employment growth.

Source: Organisation for Economic Co-operation and Development (OECD). OECD projections June 2023.

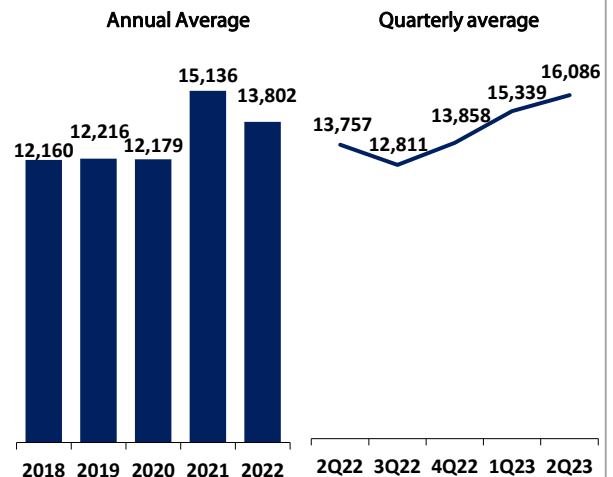
- ▶ Compared to other European countries, Germany has experienced two periods of negative growth and is in a period of economic stagflation (a combination of negative growth and high inflation). Moreover, the Bundesbank expects another quarter of negative growth.
- ▶ Although public consumption has been the component of domestic demand that has weighed most heavily on the economy, positive developments in capital formation have offset part of the negative impact on GDP.
- ▶ The German labour market remains solid and unchanged. Unemployment remains very low and consists mainly of structural unemployment.
- ▶ Finally, foreign trade declined only slightly, while the trade balance shifted slightly towards a trade surplus.

Treasury Yield Curves Rates (%)



Source: Investing.

DAX 30



Source: Investing.

3. Banking sector

The year-on-year growth rates of total loans and deposits in the German banking sector continued to decline in 2Q23. The efficiency ratio continued its improving trend, but still far to closing the gap with EU average. Interest rate continued its upward trend initiated in 2022.

BUSINESS	BANKING SECTOR CONTEXT 2Q23 (%)					Var. p.p.1Q23	Var. p.p.2Q22
	2Q22	3Q22	4Q22	1Q23	2Q23		
TOTAL LOANS*	5.94	6.56	5.57	4.69	3.48	-1.21	-2.46
TOTAL DEPOSITS*	6.13	8.39	7.79	5.77	4.46	-1.31	-1.67
LTD RATIO	108.93	108.12	108.76	108.81	109.07	0.26	0.14
EFFICIENCY							
EFFICIENCY RATIO	70.12	70.61	69.47	68.22	64.41	-3.82	-5.72
EU AVERAGE	61.39	61.00	60.65	59.18	56.54	-2.64	-4.85
RISK							
NPL RATIO	1.00	0.99	1.08	1.05	1.14	0.09	0.14
EU AVERAGE	1.81	1.76	1.80	1.75	1.81	0.06	0.00
COVERAGE RATIO	35.26	35.19	34.69	35.06	33.03	-2.03	-2.23
EU AVERAGE	43.81	44.07	43.49	43.64	42.93	-0.71	-0.88
SOLVENCY**							
CET 1	15.07	14.81	15.66	16.03	16.43	0.40	1.36
LEVERAGE RATIO	4.88	4.69	5.30	5.18	5.45	0.27	0.57
LCR	149.76	148.64	153.75	148.55	145.67	-2.88	-4.09
ECB INTEREST RATE							
INTEREST RATE	0.00	0.50	2.50	3.50	4.00	0.50	4.00

Source: Deutsche Bundesbank.

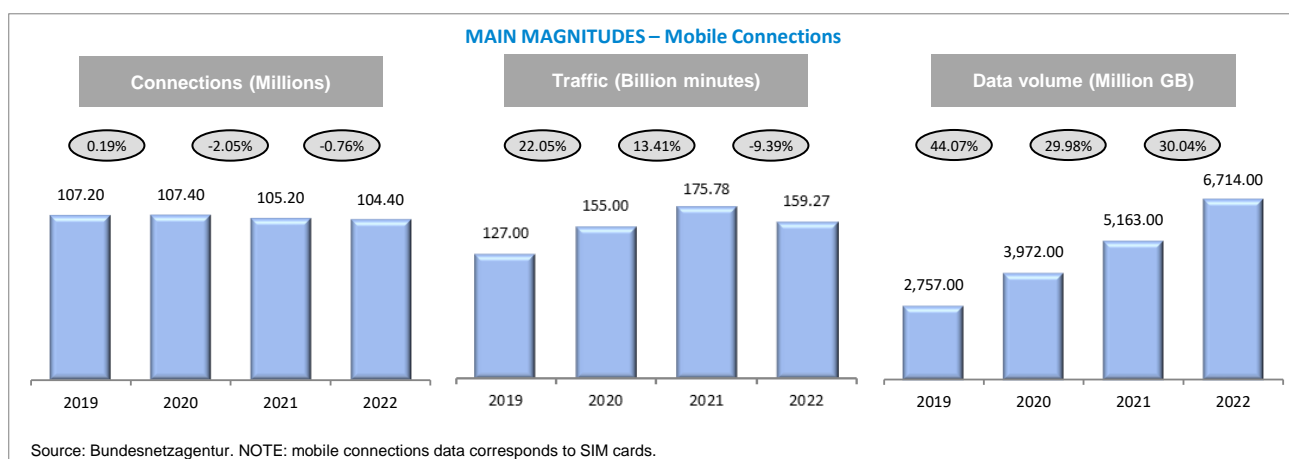
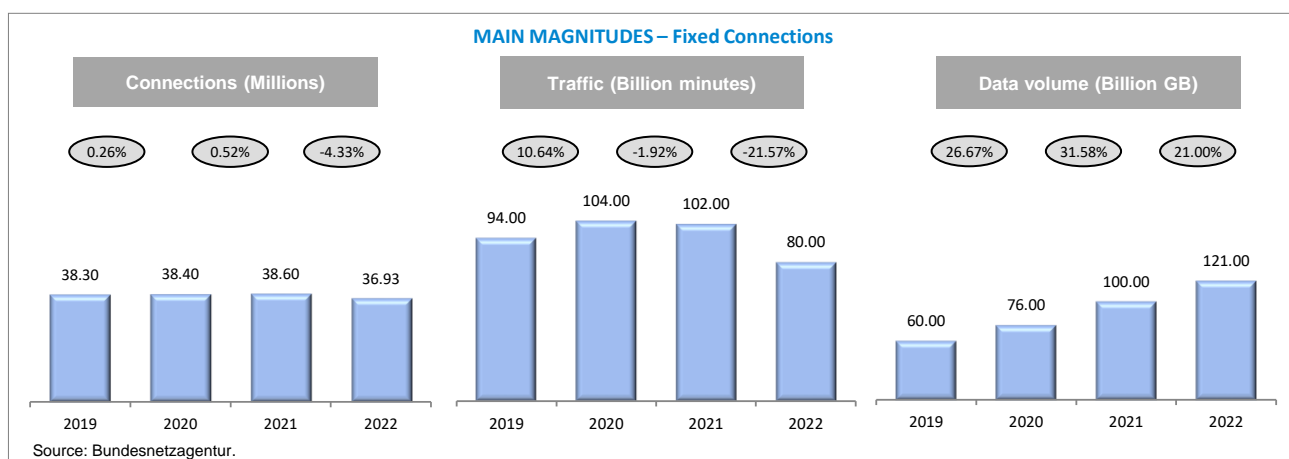
*Note: The values for loans and deposits reflect their year-on-year growth rates. **Note: CET1 ratio measured as fully-loaded and Leverage ratio as fully phased-in definition of Tier 1.

- ▶ Both total loans and total deposits decreased their year-on-year growth rates compared to 2Q22 by 2.46 p.p. and 1.67 p.p. respectively. Moreover, they did decrease compared to 1Q23 by 1.21 p.p. and 1.31 p.p. respectively. The LTD ratio increased 0.14 p.p. compared to the second quarter of 2023 to 109.07%.
- ▶ Although the efficiency ratio improved by 5.72 p.p. compared to 2Q22, the ratio was still above the EU average (64.41% vs. 56.54%).
- ▶ The NPL ratio slightly worsened by 0.09 p.p. and by 0.14 p.p. compared to 1Q23 and 2Q22, respectively. While the German NPL ratio was better than the European average, the German coverage ratio was still below the EU average, at 33.03% compared to 42.93%, respectively.
- ▶ The CET1 ratio of the German banking sector improved compared to 1Q23 and 2Q22, by 0.40 p.p. and 1.36 p.p. respectively. Leverage ratio increased by 0.57 p.p. year-on-year, to 5.45%. Regarding LCR, the ratio registered negative growth of 2.88 p.p. and 4.09 p.p. compared to 1Q23 and 2Q22, respectively.
- ▶ ECB interest rates had been steady at 0.00% for eleven years, until the authorities decided to increase them in June 2022 to 0.50% as a measure to reduce inflation. Since then, ECB policy has kept an ongoing upward trend regarding interest rates in order to fight persistent inflation, reaching 4.00% in 2Q23, which means a 4.00 p.p. year-on-year increase.

4. Telecommunications*

In 2022, the number of fixed connections decreased its level to 36.93 million, as did mobile connections which experienced a decline in their number of connections down to 104.40 million. During 2022, fixed traffic experienced a considerable decrease of 21.57% to 80 billion minutes. Mobile traffic also declined by 9.39% down to 159.27 billion minutes.

- ▶ The volume of fixed connections decreased its level during 2022 compared to 2021, down to 36.93 million connections. Regarding traffic, fixed lines experienced a significant decrease of 21.57% during 2022, down to 80 billion minutes.
- ▶ In terms of mobile connections, a decrease of 0.80 million connections was registered, 0.76% below the number of connections reported in 2021. During 2022 the number of mobile connections reached 104.40 billion. Mobile traffic also decreased 9.39% compared to the previous year, down to 159.27 billion minutes.
- ▶ The number of broadband connections continued to grow to 37.5 million in 2022, a y/y increase of 2.74% mainly attributed to the increase of FTTB/FTTH technologies (+47.83%, to 3.40 million connections).
- ▶ Furthermore, the fixed broadband data volume grew by 21% in 2022 compared to 2021, to 121 billion GB of data. Mobile network data volume also increased by 30.04% compared to the previous year, to 6.71 billion GB in 2021.



5. Glossary

- ▶ **BUSINESS VOLUME:** The business volume is the set of activities that generate income for a bank, formed by financing (loans) plus customer resources (deposits).
- ▶ **CET 1:** Common Equity Tier 1 capital is the highest quality of regulatory capital, as it absorbs losses immediately when they occur.
- ▶ **COVERAGE RATIO:** It is a ratio that informs us about the protection that financial entities have against the unpaid loans of their clients. It is represented as the total provisions that the entity has over the total doubtful loans.
- ▶ **CPI:** The consumer price index is an indicator that measures the variation of prices of a basket of goods and services in a specific location during a certain period of time.
- ▶ **EFFICIENCY RATIO:** It is a ratio that measures the productivity of an entity. It is the result of the quotient between operating expenses and gross margin. In other words, it relates the income obtained with the expenses necessary for its achievement. As a conclusion, an entity will be more efficient the lower its efficiency ratio.
- ▶ **FSAP:** Financial Sector Assestemnt Program.
- ▶ **GDP:** Gross Domestic Product (GDP) is an economic indicator that reflects the monetary value of all final goods and services produced by a territory in a certain period of time. It is used to measure the wealth generated by a country.
- ▶ **GM:** Gross Margin.
- ▶ **GM/ATAs:** Gross Margin / Average Total Assets. Gross margin is composed of the set of revenues generated by a financial entity in its activity.
- ▶ **IMF:** International Monetary Fund.
- ▶ **LBBW:** Landesbank Baden-Württemberg.
- ▶ **LEVERAGE RATIO:** The Tier 1 leverage ratio measures a bank's core capital relative to its total assets. The numerator consists of the most stable and liquid capital, as well as the most effective at absorbing losses during a financial crisis or recession. The denominator is a bank's total exposures, which include its consolidated assets, derivative exposures and certain off-balance sheet exposures.
- ▶ **LCR (Liquidity Coverage Ratio):** this ratio measures a bank's liquidity. It is calculated as the institution total liquid assets divided by its short-term obligations.
- ▶ **LTD RATIO:** The loan-to-deposit ratio (LDR) is used to evaluate a bank's liquidity by comparing the total loans of a bank with the total deposits during the same period.
- ▶ **NPL RATIO:** The non-performing loans ratio is an indicator used to measure the volume of operations that have been considered non-performing, in relation to the volume of loans and credits granted by said entity.
- ▶ **OE:** Operating Expenses.
- ▶ **OE/ATAs:** Operating Expenses / Average Total Assets. Operating expenses are those that an entity incurs during the exercise of its activity.
- ▶ **OECD:** Organization for Economic Cooperation and Development.
- ▶ **p.p.:** percentage points.
- ▶ **ROA:** An indicator that measures the profitability of a company in relation to its total assets. It indicates the return that is being obtained for its assets. It is calculated as the quotient between profit and total assets. The profit used is that obtained before taxes and interests.
- ▶ **ROE:** Financial profitability is also known as return on equity, which relates the net profits obtained in a given investment operation with the own resources.

6. Appendix

MACROECONOMIC OVERVIEW

- ▶ Deutsche Bundesbank:
www.bundesbank.de
- ▶ European Central Bank: <http://www.ecb.int>
- ▶ Handelsblatt:
<https://www.handelsblatt.com/>
- ▶ International Monetary Fund, IMF:
<http://www.imf.org>
- ▶ Organisation for Economic Cooperation and Development, OECD:
<http://www.oecd.org/home/>
- ▶ Standard & Poor's:
<http://www.standardandpoors.com/>
- ▶ World Bank : <http://www.worldbank.org/>

BANKING SECTOR

- ▶ Deutsche Bundesbank:
www.bundesbank.de
- ▶ European Banking Authority (EBA):
<https://eba.europa.eu/>

TELECOMMUNICATIONS

- ▶ Bundesnetzagentur:
www.bundesnetzagentur.de

Entities considered for Efficiency ratios:

Aereal Bank AG, Bayerische Landesbank, Commerzbank AG, DekaBank Deutsche Girozentrale, Deutsche Apotheker- und Ärztebank eG, Deutsche Bank AG, Deutsche Pfandbriefbank AG, Deutsche Zentral-Genossenschaftsbank AG, Erwerbsgesellschaft der S-Finanzgruppe mbH & Co. KG, HASPA Finanzholding AG, HSH Nordbank AG, Landesbank Baden-Württemberg, Landesbank Hessen-Thüringen Girozentrale, Landeskreditbank Baden-Württemberg-Förderbank, Landwirtschaftliche Rentenbank, Münchener Hypothekenbank eG, NORD/LB Norddeutsche Landesbank Girozentrale, NRW.BANK, Düsseldorf, State Street Europe Holdings, VW Financial Services AG, Westdeutsche Genossenschafts-Zentralbank AG.

ACRONYMS

- | | | | | |
|-----------------|-----------------------|--------------------|----------------------|--------------------------------|
| ▶ DEU - Germany | ▶ LUX - Luxembourg | ▶ TUR - Turkey | ▶ ECU - Ecuador | ▶ ZAF - South Africa |
| ▶ BEL - Belgium | ▶ NLD - Netherlands | ▶ ARG - Argentina | ▶ MEX - Mexico | ▶ UEM- European Monetary Union |
| ▶ DIN - Denmark | ▶ NOR - Norway | ▶ BRA - Brazil | ▶ PER - Peru | |
| ▶ ESP - Spain | ▶ POL - Poland | ▶ CAN - Canada | ▶ USA- United States | |
| ▶ FIN - Finland | ▶ PRT - Portugal | ▶ CHL - Chile | ▶ AUS - Australia | |
| ▶ FRA - France | ▶ GBR- United Kingdom | ▶ COL - Colombia | ▶ CHN - China | |
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