The fall of German banking

Painful aftermath to failed merger talks

by David Marsh in Berlin

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Former German Chancellor Helmut Schmidt used to lament how Germany's giant banking groups would stoke up dangerous enmity among neighbouring countries by inevitably dominating European finance. A senior French banker once told me that French and German banks would never merge because the Germans would always have the upper hand – partly because German bankers were bigger and taller than their Gallic counterparts.

Those fears from past decades now look near-comical. The collapse of merger talks between Deutsche Bank and Commerzbank, the No.1 and No.2 German lenders, marks the latest episode in a 30-year downward spiral of German banks that were once by far Europe's best capitalised financial institutions. In 1990 Deutsche was worth the combined totals of most of its European rivals. HSBC, now Europe's highest capitalised bank, is worth around 10 times that of the bank that bears the name of Europe's largest economy.

This is the third time since the beginning of the century that attempts to consolidate Germany's heavyweight but below-par private banks have run into failure.

In 2000, a much-heralded merger between Deutsche and Dresdner Bank, its long-standing domestic rival, was abandoned above all because of opposition from Deutsche's London-based investment bankers. In 2008, a second-best merger between Dresdner (which had been taken over in 2001 by the Allianz insurance group) and Commerzbank was consummated – but, laid low by the financial crisis, the link never produced the desired outcomes.

At each setback, German commentators bemoan the lack of competitiveness of the country's stock market-quoted banks. The reasons for the shortcomings have been extensively diagnosed. They are fighting against the triple challenge of Germany's established co-operative and state-backed savings banking networks, European competitors that have far more successfully consolidated their national banking markets in the past 20 years , and US institutions extensively recovered from the 2008 financial crisis.

One notable casualty will be Paul Achleitner, Deutsche's luckless supervisory board chief, who has been (along with Olaf Scholz, the German finance minister) one of the few strong backers of the deal. Achleitner will again have to readjust a strategy that has been singularly lacking in conviction and results.

The biggest fall-out may emerge in the political sphere. In contrast to Scholz, Chancellor Angela Merkel, who will bow out as Germany's leader in the next year or so after 14 years at the helm, never gave overt support to the deal, fearing trade union opprobrium over job losses.

Owning 15.6% of Commerzbank following a post-crisis capital injection that has spectacularly failed to pay out for German taxpayers, the Berlin government will have a big say in the aftermath. This is likely to demonstrate Germany's vulnerability to economic setbacks – and this will have difficult political consequences, too.

Both Deutsche and Commerzbank are in positions of extreme weakness, with share prices down more than 90% from their pre-crisis highs. Their combined market capitalisation of €29bn is dwarfed by €83bn for Spain's Santander, €69bn for France's BNP Paribas, €52bn for the Netherlands' ING Group, and €32bn for Italy's Unicredit. At least two of these institutions are contenders to buy Commerzbank. And a foreign bid for Deutsche Bank – once unthinkable – may not be far off.

Germany will be under pressure over its European policies, too. Berlin's previous backing for the merger and formation of a 'national champion' appeared to counter some key precepts of European banking union that Germany otherwise says it supports. Merkel and Scholz will now face pressure from France and other European partners for Berlin to invite European bids for either of its top banks. This could invite strong questioning, especially from France, of Germany's ultimate European goals.

If a foreign bid went through, many German politicians believe the country could be exposed in the next financial crisis to a lack of nationally strong banks helping to shore up domestic industry. As the Frankfurter Allgemeine Zeitung daily wrote on Friday, 'The Germans don't like their banks. They may see their benefits only when there are none left.'

If, on the other hand, the Germans block foreign bids on indirectly protectionist grounds, this would cause a major backlash around Europe. Banking could be the ultimate battleground where Germany must decide between national and European priorities. Whatever happens, for Germany this will be painful.

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