Deutsche Bank: Flash info

I. What's happening?

- Sharp fall of the share price today after large rebound since Monday morning.
- Widening of the CDS since Thursday.

II. Why the panic now?

It is always **hard to rationalise such moves** but here is our attempt:

- Even if DB is very different from CS (see below) the immediate reaction to the events on CS have often been "What about Deutsche?". A few years ago, Deutsche looked very much like CS now and it's still on many people's mind.

- News flow: nothing much, just news yesterday of global investigations by OFAC on Russian sanctions. DB could be involved (but no specific news unlike UBS & CS.).

- The US have had a very confusing communication on their banking crisis. Deposit guarantees remain on the agenda but with contradictory statements from Yellen, Powell, etc. First Republic is still not solved and highly unclear. The general problem of unrealised losses and deposit stability remains. In that context, people are reducing exposure ahead of the weekend (expect news on First Republic).

- Some IBs have probably been hedging their counterparty risk on Deutsche post Credit Suisse crisis. This is mostly done through the CDS market. Since FRTB rules the single name market is very illiquid and small flows are enough to move prices a lot.

- DB called a Tier 2 bond this morning :
  https://www.db.com/news/detail/20230324-deutsche-bank-announces-decision-to-redeem-its-fixed-to-fixed-reset-rate-subordinated-tier-2-notes-due-2028
  This is normally a very good piece of news, both from a pure P&L point of view and it shows that the ECB is comfortable with DB (DB had to ask permission to the ECB before taking this decision). However, in volatile markets, this can be interpreted as DB wanting to show they are strong...meaning they are not!

This sounds odd but is certainly on people's minds after CS tried a buyback a few days before the takeover. This is obviously not the right way to think about it because call decisions are taken months in advance to get supervisory approval, but not everyone is aware of that.

III. What are the fundamentals?

On a fundamental point of view, DB is now profitable, has a good momentum and strong metrics (capital, liquidity.):

- 2022 was the most profitable year for DB (5.5bn) since 2009, after years of restructuring.
- The German retail bank benefits enormously from higher rates.
- Consensus 2024 ROE is above 7% - reasonably good for an EU bank.
- The share of insured deposits is in the EU average (around 35%) for large banks as they have big clients (DB is a so-called money centre bank). Retail deposits are guaranteed at 70% (in amount, so much more in terms of number of accounts).
- DB has negligible unrealised bond book losses which are not already included in their CET1 ratio.
- Litigation risk has gone down sharply over the past few years, with only a few numbers of important cases outstanding, and they have been largely provisioned. We think what remains is within the contingent liabilities of €1.9 billion.
- DB's interest rate risk in the banking book in a parallel shock scenario is 4.6bn. However, this is for a large 200bps shock from the level of interest rates in Dec 2022.
- DB's leverage is at its lowest since the 1990s.
- Even during Q1 2016, when the market was concerned about DB (fear of coupon skip, oil & gas exposure, litigation), the bank's liquidity position remained strong, with barely any deposit outflow and liquidity reserve intact.

- One weakness of DB attracting a lot of attention is its commercial real estate loan portfolio, especially in the US (17bn). DB recently gave a lot of details on that portfolio, which is diversified and had a LTVs of 61% in mid-2020. The SSM recently imposed additional capital requirements to mitigate this risk. Overall (i.e., not only US) DB has CRE exposure below the average of its peers.

- Another perceived weakness is that Deutsche has a very large derivatives book and Level 3 assets. However, the model was entirely inspected by consultants when the ECB took over the supervision and it resulted in a change of value of the book of € 13m, a rounding error compared to the size of the book. This is not a toxic and grossly mismarked book.

- Deutsche has a Q4 2022 Liquidity Coverage ratio of 140%, in the EU average. A major difference is that CS had 100% of their retail deposits flagged as non-stable deposit whereas DB has 2/3rd of stable deposits. DB had stable deposits in Q4, no outflows. The crisis at CS has shown that a major problem with the LCR is the "nonstable deposit" bucket for which outflows far exceeded the 10% parameter of the LCR calculations. Out of DB's € 285bn of corporate deposits approximately €90bn are transactional deposits that cannot move quickly. DB could also raise significant amounts from the central bank by pledging private claims or securities: it has € 211bn of unencumbered EHQLA and HQLA assets and € 1,150bn of other unencumbered assets.

Therefore, we believe the comparisons with CS are tempting but very superficial.

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