

Bulletin:

Commerzbank AG Moves Closer To Its Financial Targets But Economic And Geopolitical Risks Remain

August 3, 2022

FRANKFURT (S&P Global Ratings) Aug. 3, 2022--S&P Global Ratings said today that Commerzbank AG's solid operating performance in second-quarter 2022 demonstrates clear progress in its transformation and toward its 2024 financial goals. Improved structural profitability also provides a buffer against expected asset quality pressure from economic headwinds and continued extra costs at its Polish subsidiary mBank S.A. (BBB/Developing/A-2).

Commerzbank (BBB+/Stable/A-2) reported a 6.7% return on tangible equity for the second quarter, which is already much closer to the more than 7% actual target for 2024. The group continues to outperform revenue expectations, largely because of strong interest rate tailwinds in Germany and Poland. Its corporate bank also demonstrated improved profitability, partly related to more cyclical customer demand for hedge and forward products amid a volatile environment. At the same time, it marginally increased its cost target for full-year 2022 to €6.4 billion after the extraordinary contribution to the institutional protection schemes.

Commerzbank's reported cost-to-income ratio of 64% (including extra related costs) for first-half 2022 is almost in line with its 61% target for 2024. However, it will weaken over the second half when the group estimates it will pay up to €290 million related to credit holidays for private mortgages in Poland (see "Polish Banks To Be Hit By Government Action Allowing Broad-Based "Credit Holidays", published July 20, 2022, on RatingsDirect). Profitability remains supported by still low net credit loss charges of €106 million (24 basis points annualized as reported) for the second quarter, after the group booked some Russia-related defaults against its management overlay, which remains at €564 million.

The stable outlook reflects our expectation that Commerzbank's multiyear restructuring will succeed. We think it has gained momentum and management credibility to largely reach its 2024 financial targets. However, this would mean it remains unable to cover its cost of capital. We note several key risk factors for the plan, including:

- A material slowdown in revenue growth due to, for example, weaker support from interest rates because of more quickly rising deposit rates in Germany.
- Reduced or delayed cost benefits from the planned reduction of full-time-equivalent employees, strong inflationary cost pressure, or disruptions in the digital transformation.
- An abrupt and permanent halt to Germany's imports of Russian gas could severely challenge

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asset quality and lead to elevated credits losses. The group already disclosed that a cut-off of Russian gas exports to Europe could add a net €0.5 billion–€0.6 billion to the management overlay over 18 months. However, it already assumes certain fiscal support measures.

- Increased costs at mBank from litigation risks and the government's borrower support program on top of measures already agreed.

Commerzbank's common equity Tier 1 ratio was a favorable 13.7% at June 30, 2022, which provides a further buffer against economic and geopolitical risks. In line with management guidance, we anticipate that achieving its financial targets would set the stage for a sizable capital return. We think this is consistent with our 9.5%-10.0% risk-adjusted capital ratio projection until 2024.

Related Research

- Commerzbank AG, July 20, 2022
- Polish Banks To Be Hit By Government Action Allowing Broad-Based "Credit Holidays", July 20, 2022
- Geopolitical Risks Add Headwinds For German Banks, Despite Robust Capitalization, July 19, 2022
- Another Turn Around The Dancefloor As European Governments Eye New Bank Windfall Taxes, June 9, 2022
- mBank Outlook Revised To Developing On Risks From Swiss Franc Loans And Build-Up Of Bail-In Buffers; Ratings Affirmed, June 9, 2022
- Commerzbank Outlook Revised To Stable On Improving Revenue Prospects, Reduced Transformation Risk; 'BBB+' Affirmed, May 23, 2022
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