FIVE BULLETS
ON THE LESSONS LEARNED FROM DEUTSCHE BANK

Marcello Messori

DEUTSCHE BANK'S DIFFICULTIES, which exploded due to a multi-billion dollar fine required by the U.S. Department of Justice, have been noted for some time. Much depends on its global economic projections, which were particularly vulnerable to tougher regulation and the flattening of yield curves, as well as the complexity of the banking group's financial activities, which had not been subject to rigorous risk management or adequate governance. The consequent opacity of Deutsche Bank's books hinders accurate prediction over whether its balance equilibrium can be restored through deleveraging, the sale of certain branches, and market recapitalization alone, or if state aid will be required. It is a simple matter, however, to forecast that a formal crisis is not forthcoming for Deutsche Bank (i.e., European resolution processes, as designed in the second pillar of the Banking Union, are unlikely to be triggered). Since Deutsche Bank is very much interconnected with international financial markets, its formal crisis would create a potential of systemic instability, which would be unmanageable.

This reasoning would seem to suggest two inferences:

- Considering that the difficulties plaguing Italian banks have found an "equivalent" at the heart of the Euro area, overly severe supervision or regulation must be to blame, so Italy should not be forced to undergo radical adjustments.

- A continental European investment bank cannot compete with those of the United States.

However, in my opinion, neither assertion is sound. Instead, the following three points should be considered:

- Even though a large part of the Italian banking sector and local German banks share the same structural fragilities (over-branching, inefficient allocation of credit, and low profitability), Deutsche Bank's problems are the result of an opposite business model, centered on globalization and financial speculation.

- The failure of the Deutsche Bank model does not mean that the Euro area needs to bow down to a monopoly of US investment banks; quite the opposite, at least in the short-to-medium term, investment banking could provide positive spillovers and achieve higher profitability in the Euro area than in the United States.

- The above statement is proven by the fact that, following the financial crisis of 2007-09 and subsequent reorganization of financial markets, US investment banks adopted the legal status of retail banks and combined their preexisting financial activity with more traditional services, diversifying their sources of income; in the Euro area, overcoming bank-centrism requires, instead, an increase in investment banking services in order to create a richer and more efficient European financial market.

The conclusion is two-fold. First, the case of Deutsche Bank indicates that, in the Euro area, speculative activities need to be prevented without renouncing investment banks, which are an essential ingredient for building efficient and well-regulated financial markets; without it, the Capital Markets Union would never see the light of day. Second, the business model in need of substantial changes is that of traditionally specialized banks; if their primary source of income continues to be interest margins and the trading of sovereign bonds, these banks will indeed be condemned to marginalization.