Deutsche Bank AG

Bank of America Financials Conference

Thursday, 22 September 2022

Transcript

Speakers:
James von Moltke, Chief Financial Officer
Rohith Chandra-Rajan, Bank of America

Rohith Chandra-Rajan:	Good morning, everybody. Thank you very much for joining us for this session with Deutsche Bank CFO James von Moltke. I'm very pleased to welcome James. It's great to have you here in person. Thank you.
James von Moltke:	Thank you, Rohith. I appreciate for you hosting us today.
Rohit Chandra-Rajan:	I guess just kicking off on the strategy, you've had to navigate difficult and fast-changing economic conditions since the strategy was set back in 2019, and that continues. What are the key achievements to date and the main challenges ahead to meet your 2025 targets? In particular, what are the levers that you're pulling to adapt as the environment evolves?
James von Moltke:	Sure, Rohith. Thank you for the question. Lots to talk about. It feels like an age since we announced our Compete to Win strategy in July of 2019. And of course, none of us could have foreseen what the challenges are that we would face in that time. But I think something that we're all proud of at Deutsche Bank is we've been able to execute faithfully on the strategy that we talked about at that time. We created four core businesses that are leaders in their market. We exited non-core businesses. By doing so, we freed up capital and maintained our ratios, without raising capital, at the levels that we've targeted. We've been cutting costs in the organization, and at the same time investing in technology and controls and our businesses in the front office. So, we think these last three years have been sort of a period of really remarkable transformation for the organization. As we think back on the challenges of COVID in 2020 and beyond, of this year with energy prices and the impact of the war, I don't think the company would have been as ready to handle those situations as we have been. And so another point of pride is being our ability to support the economy, support our customers through these periods of challenge. It's a lot of work, so we're closing out on what we call Compete to Win, which had a set of targets and objectives for 2022. In March of this year, we

announced a new period, a phase for the company through to 2025 with strategic objectives, which frankly are a continuation of building the businesses, building our revenue growth, and continuing a process of improving the efficiency of the company. The transformation will continue.

So Rohith, to your question, we've faced some challenges this year. I think we're doing well in surmounting those challenges. We can talk a little bit about 2022 and what we see happening from here.

As you look to 2025, I'd say a couple of things. One is of course the economic environment has changed since we built our assumptions for 2025 that we shared with investors in March. But nothing about the direction of travel would change at all for us. We think it's the right strategy then and now. We think we can be resilient even with those changes in economic variables in the environment.

As I look at those variables today, the growth rates are actually not that different in 2025. There's likely to be some growth, some economic growth forgone now in 2023 and 2024 relative to the assumptions we had then. But frankly, from a revenue perspective, our calculations today would say that foregone growth is more than offset by higher interest rates. So, we don't think these macroeconomic variables are going to put us off pitch, if you like, in executing on our strategy from here.

There's a lot of work to do. Among other things, we need to dig deeper and work harder to offset the impact of inflation on the cost base. We're working hard on that. I think that challenges all the banks and every corporate and household globally. But it's something that we're focused on, and we'll have more to say on in time.

Rohith Chandra-Rajan: Thank you. We'll probably come back to some of those points. You invited me almost I think there to ask about 2022. So how should we think about progress through the remainder of this year?

James von Moltke: We're very pleased with the momentum that our businesses have had this year. Again, notwithstanding a volatile environment and changes in the market environment, this momentum that has come from the focused business model we have, the client engagement in our businesses has continued through the third quarter.

And it also makes us feel good about the portfolio we have. So certainly, there have been pockets of weakness that we've talked about this year. Those trends have clearly continued into Q3. And so there have been weaknesses, for example, in Asia Wealth Management, we talked about. Obviously, Origination and Advisory has had a very difficult year in terms of just the flow of transactions in the marketplace.

But the strength that we've seen in our core businesses, continued momentum in the Corporate Bank, momentum in the Private Bank, both Wealth Management outside of Asia and in Germany, the support from interest rates. And in particular also, the outstanding performance of our FIC business and within FIC the macro products, has really set us up very well.

So Rohith, we've talked about a range of guidance for revenues of 26 to 27 billion euros for 2022. We continue to think that we're at the high end of that range. We've talked about credit loss provisions. Even with all of the events that we've faced this year, the energy crisis, we gave guidance back in March of 25 basis points for the year of average loans. And we think that's still entirely correct guidance based on what we see today.

We did have to change the cost/income ratio target that we initially had for this year mid-to-low 70s. That's something we continue to work towards. And so that's our model, and we continue to execute through this third quarter.

Rohith Chandra-Rajan: Thank you. Just then following up on the cost point, which has been a particular area of focus, as you said, you've had to change the guidance. I guess in particular, costs of control, technology investments are particular areas of growth. Can you talk a little about how you plan to manage those as well as broader inflation, whether there's scope for more efficiency improvements? And would there be any upfront costs associated with those?

James von Moltke: I'll start with the statement that we're focused on costs absolutely every day. We recognize it's a critical part of continuing, and frankly, improving. Now that we've established sustainable profitability, we need to continue to improve on that, enhance our margins. And a big part of our Investor Day materials in March is over the next three years continuing that progress in terms of our cost/income ratio. So, it has our absolute focus.

Rohith, as you said in the second quarter, we talked a little bit about why we were seeing an efficiency ratio at about 73% in the year-to-date rather than the 70% we targeted. A lot of that was decisions that we made to preserve, and in fact, enhance investments in technology and in controls. And we think those were the right decisions for the company.

Now layered on top of that were some things that were out of our control, and both on the revenue line and the expense line that made that calibration tougher than we had expected and hoped it would be. But we think that we've made the right decisions for the company in the long term, and we're focused on generating that long-term value.

You asked about the levers, and I use the word transformation. I recognize transformation is often overused as a term in our industry. But we're doing a huge amount of work in well-defined initiatives in the company that are delivering benefits this year and in the years to come.

Again, we talked about that in March, but it relates to investments we've made in rationalizing the German distribution network and the technology that supports our businesses in Germany. So not just the Private Bank, but also Corporate Bank and other activities in Germany.

We talked about the investments in technology and building a much more efficient platform, sort of managing through the legacy estate that we have that still represents a pretty heavy burden for us. We talked about a set of investments we're making in front-to-back process and also data flows in the company to drive efficiency and improve the operations of the company, and just simplify the activities.

And lastly, we think in target workforce models, particularly in the infrastructure that supports our businesses, there's a lot more we can do in, again, rationalizing and making the organization run more efficiently. So those are in big buckets, all of which breaks down to smaller projects, the four initiatives that will drive 2 billion euros of cost savings to 2025 relative to 2021.

Now we've got to make sure we deliver on all of the promises there. We have to find ways to expand the delivery in those four areas and look for additional measures that we can take. And that's something that we're working on now because we recognize that the inflation assumptions have run much higher than people could have expected. And while in the near term we've had some sort of buffering against inflation, we've seen some pressures this year. We recognize that over time those pressures will persist, and we need therefore to work to offset them.

Rohith Chandra-Rajan: Thank you. And then moving to income, you talked a little bit about FIC and O&A in terms of current conditions. I don't know if you wanted to expand it all in terms of Q3. And then looking out more broadly, what do you see as the structural drivers of the revenue pull for the Investment Bank? How is Deutsche Bank positioning itself in terms of product capability to gain market share? How do you see that evolving over the coming years?

James von Moltke: So Rohith, it's a great question. On the latter, it's something we're focusing on very intently and an interesting topic as we look forward to 2023 and beyond.

But if I focus to begin with on the third quarter, back about 18 months ago or so we started talking about a range of revenues in the Investment Bank of between 2 and 2.5 billion euros. We started talking about that because we were seeing with the business mix we have a relatively reliable revenue stream each month, each quarter, which was giving us the confidence that the businesses were just working. Again, with a portfolio that has proved pretty resilient even as the markets have moved.

This quarter, we think we'll be well within that range in the IB. As I mentioned, reflecting some of the trends that we've talked about all year. So, FIC remains very strong in its performance, particularly the macro businesses. Rates and FX have performed outstandingly this year. Also, Emerging Markets.

And our Financing business where we lend and we also originate and distribute credit, that has been functioning very well. Our Credit Trading businesses have been weaker. That has also persisted in the third quarter. But overall, that mix has led to, I think, a very strong performance in FIC, both sequentially and year on year.

Our Origination and Advisory businesses, I think as you've heard from peers and you can see in the market data, market data suggests the revenue wallet is down about 45%. That's certainly a trend that you're seeing in our numbers. And in addition, we and other banks have seen mark-to-market losses on the pipeline in leveraged debt capital markets, and that's persisted also into the third quarter. So again, the portfolio effect of the continued strength and resilience in the Investment Bank revenues is notwithstanding areas in O&A that have struggled.

You ask about the future. Look, we think we've created a business in these FIC markets areas that are among the leaders in our industry globally. And that's a real credit to Ram Nayak and his team over the past several years from 2019 to now to have re-established ourselves firmly in the top four or five FIC houses globally. And we think that that can persist.

Certainly, in the near term, our sense is the volatility will continue as central banks act and the markets find their level around rates in FX, these big adjustments that have been taking place this year. You'd expect that to begin to normalize over time. How soon that is, nobody knows. Maybe fourth quarter this year, first quarter next year, perhaps even later.

At the same time, though, you'd expect that the capital markets businesses would begin to come back. Typically, these lulls in capital markets in periods of time with volatility and weaker valuations last about four to six quarters. And after that, you see the market find its footing and begin to lift. So, sitting here today if I were to make a bet, it would be the second half of next year that you'd start to see O&A come back.

Now importantly, looking to 2023, I wouldn't expect the same challenges in the credit trading markets to roll over into next year as we've seen this year. So again, I would suspect in 2023 there's again a transition. Macro beginning to slow down, credit and capital markets activity beginning to stabilize and pick up.

One last thing, not to go on too long on the question. Where are our investments? We talked about in March sort of reinvesting in our client franchise, in our M&A capabilities. We think we're underrepresented there relative to our client footprint globally and what we're capable of. And of course, M&A has performed a little better this year than the other products.

But the important thing is it's a gateway product, as we all know, to capital markets activities and other financing. So, we think that that remains an area of opportunity for us as we recapture some of the market share that we've lost over the past few years.

Rohith Chandra-Rajan: OK. There's a couple of audience questions on the Investment Bank, so maybe we can cover those while we're on the topic. One is just whether you could elaborate on the investments in product capability within the FIC business and what it takes to maintain that top four or five ranking, and why that's important. And then secondly, your appetite potentially to get back into equities or not.

James von Moltke: The latter one's an easy question. No appetite to get back into equities. On the first one, it's also in a sense an easy question. It's people, technology, and then controls and capital resources. And we think we've been making the right investments in all of those areas.

And again, it's very gratifying to see the impact in the businesses. So, as we in some cases rebuild teams or add to teams, sometimes add leadership in our franchise, how quickly that is then recognized in the market and improves our market shares and our performance in these areas, it tells us that our franchise is strong. Clients want to do business with us.

And so, we've seen one by one as we've made investments, for example, in the European government bond and rates area, for example, that very quickly we regain a market position, which by some accounts we should have as one of the leading European banks. And that, of course, impacts revenues, and we think on a sustainable basis.

So, one by one, people, technology, good controls, and sort of back office, if you like, second line support. And then the balance sheet resources, which we can still bring to the table to support clients.

Rohith Chandra-Rajan: Thank you. And then on the more annuity-type businesses or the more stable businesses, if you like, Corporate Bank and the Private Bank, you've talked about that good momentum continuing into the third quarter. Corporate Bank particularly outperformed very well in the first half of the year. If you could elaborate a little bit just in terms of what you're seeing in terms of customer behavior, demand, and how that's been impacted by the economic environment.

James von Moltke: If I turn the clock back a year or a year and a half ago, investors were telling us the one thing you need to show the market is that these businesses, particularly Corporate Bank and Private Bank, have the ability to perform and grow. And Rohith, as you say, we've demonstrated that in the first half.

The growth rates in the Corporate Bank year on year have been well into the double digits, 26% in Q2. And the Private Bank has been in the high single digits, year-on-year growth. So, we're really pleased that we're demonstrating that.

And you'll recall that for years we'd been talking about there's underlying growth in those businesses in volumes, in client engagement and transactions. But it's being masked by the ongoing impact of negative interest rates as hedges roll off.

Now what you're seeing is the effect of continued underlying growth in those businesses. Loan volumes going up, deposit volumes going up, transaction volumes going up, but now with a little bit of a lift from interest rates and hence, you're seeing that momentum in those businesses.

That momentum continues. I think we're gratified to see the loan growth continuing also in the third quarter in both Corporate Bank and Private Bank. And so, we think that momentum is here to stay, even in a more difficult economic environment than we thought we'd be facing this year. So Rohith, it's very encouraging to see that performance and getting into the types of returns and margins that we would want and expect from those businesses.

Rohith Chandra-Rajan: When we talked about the high level earlier you mentioned probably weaker cumulative economic growth, but more than offset by rates. Back at Q2, feels a long time ago now, you talked about more than 2 billion euros of benefit from higher rates. Clearly, the curve has moved since then. Just wondering if you could update us there on what the key underlying assumptions are both in terms of rates, but also things like deposit pass-through, TLTRO, et cetera.

James von Moltke: Lots to talk about on the rate front. I mean, it's a fascinating environment for those of us who enjoy the math problems.

Back in March, we talked about revenues from interest rates with a static balance sheet, 2022 and 2025 against 2021. And I think we talked about 400 million euros initially in 2022. And then that grew to about 700 million euros this year. And we think that easily still holds as a case.

A little bit of upside obviously given the ECB moved more quickly than we had expected. So, upside that you'll see in the fourth quarter, but solidly 700 million euros of year-on-year revenue growth, static balance sheet from interest rate moves this year.

As you say, we initially shared a number of 1.5 billion euros. Same analysis, static balance sheet in 2025 based on the forward curves at that point in late February. And in Q2, we said that that had grown just on interest rates to about the high 2 billion euros for 2025. So again, a pretty significant expansion of revenues we'd expect to earn from the balance sheet based on that forward curve.

Now there are two things you need as a health warning here. One is the forward curves have to be realized. So that money isn't with us yet. There are still years to go to see how the rate environment develops.

And we will have higher funding costs. You've seen that in the marketplace. Rates and spreads have raised the funding costs, so particularly on the spread side there's some offset there. But the short version is compared to what we shared in March, I would think in 2025 at this point, a billion euros solidly of higher revenues against the 1.5 billion euros shared in March this year, again, static balance sheet.

So, then you get into the question of, well, the environment's changed. What are you going to do? How will you shape your business perhaps somewhat differently? And that's something we're, of course, giving a lot of thought to. Today the value of the deposit book is far greater than we would have thought a year ago or even six months ago.

And some of the products have changed in their characteristics as well. If you take mortgages, for example, for one thing, the capital requirements on mortgages have gone up. The market has changed and the demand has changed in the marketplace.

So, you may see us sort of shift emphasis. Again, no strategic changes, but emphasis in how we use our balance sheet. And so that's something that also has our focus now as we navigate these next few years and the changes that have taken place.

The last area to talk about a little bit when we think about this foregone growth, one effect it'll have is on loans. We think that's OK. Again, we want to use the balance sheet as efficiently as we can and support clients.

Corporate Bank, we don't really see an impact so far of the economic environment. We find that corporates are having to borrow to execute on their strategies. So, it's not clear to us that the environment will necessarily be detrimental to corporate loan growth.

With private clients, we'll have to see really how households over the next several years develop and how that performance lays out. On invested assets, naturally there's an impact, whether that's in the Asset Management business or in the Private Bank. Naturally lower market levels have an impact on the fees, but that over the years to come will depend on the market environment and how quickly we get through this period of uncertainty in both the rates and the equities markets.

Rohith Chandra-Rajan: OK, thank you. So, I guess we move on to asset quality. It's taken us quite a long time to get there, but clearly that's been a key area of focus across the last two days.

The analysis you put out in Q2 on the gas stop suggested an additional 20 basis points cost of risk. Could you just walk us through the assumptions on that and help us understand what makes Deutsche Bank so resilient? And also, you've already told us you're still confident on the 25 basis points for the year. But actually, on the gas stop, given what we've seen so far because things have moved quite a long way since Q2, if that 20 basis points is still something that you think is a reasonable estimate.

James von Moltke: Yeah, we do. A few comments on that. First of all, when we gave the-- it was about a billion euros estimate in that scenario. We were very clear it's a scenario conditions timing. Lots of things can change around that.

Among other things, the passage of time. We were speaking already at the end of July. The assumption was that gas would have stopped at the end of June.

And so, what was clear to us then already was how severe it would be for the German economy and therefore credit was going to depend on time. How much time there would be, how much the gas storage would rise before winter, how the Germans and the rest of the Europeans prepare for this through savings, organizing themselves to be more efficient in terms of energy usage, and also, by the way, government support, which we were not assuming in that 20-basis-point scenario.

So, since that time, I think in some ways all of those things have moved to the better. And hence, time really did matter. And you're not seeing the downside scenario really emerge this year.

We have to look to 2023 with some caution. There is a difficult time ahead for both households and corporates. Gas supply is one thing. And, we get through the winter with a mild winter and storages and then rationalization of usage carrying us through without a supply stop.

But you have to remember the prices are still there. And so, households and corporates will react to higher prices. And so that reduces disposable income on the one side, and it also in some cases significantly affects the economic viability of elements of the businesses that our clients do if the energy component of their production is just so uncompetitive.

So, we do expect there will be an impact. But at this point, it's very hard to say looking into 2023. Again, 2022, it's quite close. We continue to have that confidence about 2022. How much of this begins to really show itself in 2023, it's too early to say.

But we did say at the time, could it be a 35-basis-point credit loss provision year next year in that scenario? Yes, absolutely. Against 25 basis points we guided for this year.

You asked about the assumptions. We talked about top-down and bottom-up. So, the top-down is macroeconomic variables. So, a deterioration based on higher energy prices, a recession, and relatively severe economic environment similar in severity to the scenario that the ECB had laid out.

With that came forward-looking indicators. So, a deterioration in the expected credit loss would come over time. Ratings downgrades in the portfolio, and then eventually stage 3 events. Those were all the elements that we baked in.

And the stage 3, we tried to look at bottoms up. So, looking at affected industries, clients within industries. And look, we've been in very close contact with our clients now since February 24, understanding the impact on their businesses of this environment, their supply chains, the cost of energy, and their production. So, I think we've developed a better and better granular view of what's going on.

Rohith Chandra-Rajan: Could you maybe expand on that last point a little bit in terms of when you're talking to your corporate clients, particularly the energy-heavy industries, what higher prices and rationing mean, how they're managing it, how they're changing their behavior?

James von Moltke: It depends very much on the sector that you're in and also the size of the company. So how diversified is the company? How big? How many different business lines they have. If you are highly specialized in a business that energy is a significant component in, you will have a significant problem. And that, we can see in dialogue with those clients.

And at that point, it's rather like in 2020. How do you manage your resources in a way that gets you through this crisis? And that's a dialogue that we're having. And in many cases, they will rely on government support.

The larger the company, the more diversified, you're looking at things like substitution with import supports of the most energy-intensive parts of your production. You are actually ramping down production where it's no longer really profitable or competitive. You're looking for diversification of your energy sources or use if you can. It's a variety of actions that corporates are having to take. And so again, going to the commentary in the summer, time mattered in that analysis also because corporates and households can take actions to try to protect themselves from the environment that we're in.

I guess the last feature that we'll see develop over time is not just government support the way you've seen in Germany through KfW and other programs, but also what the impact at a European-wide level is going to be of price caps, of redistribution schemes to help mitigate the impact of higher energy prices on, again, households and corporates.

Rohith Chandra-Rajan: Thank you. So moving on to capital distribution, you've been very clear that there's a clear commitment to 8 billion euros of capital distributions through 2025, the dividend increasing 50% a year and sort of 4.5 to 5 billion euros of share buybacks. Could you talk about the thinking behind that and how you prioritize distributions versus investing and growing the business?

James von Moltke: We gave a lot of thought to it in the run up to our Investor Day. We asked our shareholders for a lot as we went through this transformation. Most obviously, the suspension of dividends for two years.

And so, we felt that we needed to give our shareholders a very clear sign of what they should expect on the dividend side and what management was signing up for. And so, we felt that was an important signal of restoring normality and a healthy payout to shareholders.

But because it ramps the way it does, it gave us the flexibility to manage capital using buybacks, especially in the early years as the toggle. Because the other thing, and embedded in the way you phrase your question, is we're in a world where we need to manage capital for three things. One is shareholder distributions, one is the capital support, the growth in the businesses, and the third is, of course, inflation in our capital requirements that is taking place.

And so that third element is a feature that we needed to build into that future path. We did so with a degree of prudence and conservatism that preserves the path for us, even as we adapt to the market environment and all of these unexpected events that we've encountered this year. So, we remain confident in that distribution. And we've been, I think, as thoughtful as we possibly can in our planning on how we're balancing those three items of growth, distributions, and regulatory inflation.

Rohith Chandra-Rajan: Thank you. I will carry on asking some that have come in via the tablets. Thinking about Private Bank in

Germany, rising rates are clearly a positive. The German market, the domestic market has not always been the most price-disciplined, perhaps to put it kindly. Just wondering what you're seeing or even anticipating in terms of competitive behavior.

James von Moltke: Well, there's a couple things I'd say there. One is we are continuing to invest in our domestic Private Bank franchise and our retail business in Germany in a number of ways. One is reducing the distribution footprint. And that's been part of the reasonably significant transformation charges we've taken the last few years is trying to put some of the real estate and cost burden of a shrinking physical distribution footprint behind us. There's more to do in the years to come there as we kind of right-size that, but that's one piece.

The second is to make sure the technology and our product offering is truly competitive. We think we've had competitive if you like digital capabilities in properties for some time. Certainly, the rankings and the mystery shopping and stuff that you do there tells us we're competitive.

But we think there's a real step that we can take in those capabilities, a little bit contingent on completing the conversion of the two systems into one, which we expect to finish next year. We'll be far more nimble once that's done. We're investing in the digital front end, putting that in the cloud. And we think that our pace of innovation of feature enhancement will significantly improve when that takes place because it's, of course, an incredibly important part of the future for that business.

So, we'd like to think that we've become even more competitive in that service offering. We're very competitive in our products. We're probably the leading provider of products when you go across the spectrum, especially in investment products and advice-oriented capabilities.

The other piece you referred to, though, is the use of the balance sheet. So, we talked about some of the rate-driven upside. In the balance sheet, a lot of that will be visible in the Private Bank in Germany.

But there's an interesting dynamic that we're all facing now is, how are you managing pricing in an environment where we've gone from completely unprecedented negative rates to positive rates, there's a high degree of liquidity in the marketplace which is being brought down, and on the asset side there's a change in customer behavior because of all of the economic tides that we're swimming in?

So, there's a lot we need to do to be really nimble on pricing over the coming months, years, quarters ahead. And that's something that has a lot of focus as well internally.

Rohith Chandra-Rajan: Thank you. And then M&A. You talked a lot in the past about the need for consolidation in European banking. I just wonder if you could remind us what you see as the prerequisites for that, and then also any thoughts on the part that Deutsche Bank might play in it.

James von Moltke: I heard the previous speaker's comments, and I know I share a lot of them on what the circumstances are right now in the marketplace. It is difficult into the teeth of a coming recession. Asset quality concerns, low valuations. There's a lot of things at the moment sort of pushing against.

But equally, and I think Christian Sewing and I have been consistent with our language on this, which is we think the industrial logic is absolutely there. I think that one of the things that holds back returns in the European industry is simply a scale challenge. At the end of the day today, we have these what I'll call overhead costs. We have to run technology estates, compliance, financial reporting, HR.

All of these things actually have become a much bigger part of the expense base of banks since the post-crisis regulation and all that came on top of us has taken place. And by the way, as all banks each individually have started to reduce their cost of distribution, where I think the overhead synergies are, has become a bigger part of ultimately what I see the industrial logic to be.

As ever, these things are timing -related. You don't know how it's going to take place or when. But we do see the industrial logic, and so a lot of the work we've done over the past several years I think prepares us to participate. How, when, who, all of that is simply unknowable. And as the previous speaker says, the market environment isn't helpful in today's stage and age.

Rohith Chandra-Rajan: Thank you. I think we're pretty hard up against time now, so I think we'll wrap it there, but thank you very much, James.

James von Moltke: Thank you, Rohith. Much appreciated. Thank you.