Banking Turmoil in a Declining Europe*

C.P. Chandrasekhar

Europe is clearly battling to stall its decline in the global economy. Most recently, the Mario Draghi report on "The future of European competitiveness" commissioned by the European Union reflected that sentiment. At the centre of Europe's economic decline is the descent of former leader Germany to the status of the "sick nation" of Europe. Inflation, rising unemployment, falling competitiveness, and slow growth have been plaguing the nation for the last few years.

This European disease, while leading to much handwringing on the future of Europe vis-à-vis the rest of the world, is in practice triggering economic conflict within Europe as well. A telling example of that conflict is the controversy surrounding the acquisition of a 9 per cent stake in in Frankfurt-headquartered, Commerzbank, the third largest commercial bank in Germany, by the Milan-headquartered, second-largest Italian banking group Unicredit. That acquisition has been followed by actions suggesting that Unicredit has in mind a complete takeover, executed in steps to ensure that it is not violating European Central Bank (ECB) rules regarding transfer of banking stakes in Europe.

Unicredit seems clear about its objectives, which are based on an assessment that: "there is substantial value that can be unlocked within Commerzbank, either standalone or within UniCredit, for the benefit of Germany and the bank's wider stakeholders". ECB permission is required for one European bank to acquire a larger than 10 per cent stake in another. The first step was the 9 per cent acquisition, followed by a request for permission from the ECB to raise Unicredit's stake in Commerzbank to 29.9 per cent. Additional permissions are required to raise the stockholding to 50 per cent or more.

The Unicredit move suggests that in the churn that Europe is going through, European companies are seeking to expand profit opportunities at the expense of other firms within the continent. Since Europe has lost competitiveness and the related ability to garner much profit from manufacturing, the focus is on services, with banking services being among the more lucrative among them.

Not surprisingly, the 9 per cent acquisition has triggered a standoff, in which governments are involved. German Chancellor Olaf Scholz has characterized the bid as an "unfriendly attack," and condemned what he sees as an effort "to aggressively acquire stakes in companies without any cooperation, without any consultation, without any feedback." The Italian government, on the other hand, appears to be backing Unicredit's adventure. Italian foreign minister Antonio Tajani has reportedly stated that Unicredit's actions were "more than legitimate". And not being German, the ECB President Christine Lagarde may not be opposed to a process of consolidation that could be seen as strengthening European banking.

However, the takeover story has followed a more convoluted trajectory than just a unilateral and hostile bid by the Italian bank. It was early in September 2024, Unicredit, which has reportedly been eyeing a merger with Commerzbank, acquired the initial 9 per cent stake by buying shares that were held by the German government. The government in Berlin had acquired a significant stake in Commerzbank after the 2008 financial crisis, which revealed that German banks hitherto considered as ‘staid’ and ‘safe’, had been greedy and acquired toxic derivative assets abroad, in search of higher yields and profits. When those assets lost value, banks like Commerzbank experienced an erosion of their balance sheets and had to be saved from insolvency by the government implicitly recapitalizing them by acquiring equity. Since the intention was never to actually “own and run” these banks, as things returned to normal the government was open to retrieving a part of its money through sale in the market of the equity it held.

That offered Unicredit an opportunity to acquire a stake of 9 per cent in the German bank, which it decided to seize when disappointing results led to a decline in the value of Commerzbank’s shares. The German government still held 12 per cent of the shares of Commerzbank. Unicredit wanted to enter into negotiations with the government to aquire that stake as well, and sought permission from the ECB to acquire 29.9 per cent. It did not expect much opposition, but it turned out that the 9 per cent acquisition by a single, “foreign” buyer came as a surprise for the German government.

It also triggered alarmist responses in other circles. Opposition parliamentarians argued that the entry of a profit-hungry foreign owner would adversely affect the flow of credit to small and medium enterprises, Germany’s “Mittelstand”. Unions felt that the acquisition would lead to a loss of jobs. Some of these perceptions harked back to the role of German banking in the years before the embrace of neoliberalism, the consequences of which were starkly revealed when German banks considered “conservative” and “safe” showed themselves integrated into the speculative assets and trades originating in fully deregulated US markets.

But these responses have not reined in Unicredit, which had earlier said that it would not resort to a hostile takeover or acquire a majority Commerzbank stake without the approval of the government. Following the refusal by the German government to part with the remaining 12 per cent stake it holds, Unicredit’s chief executive Andrea Orcel bought financial derivatives that provide the firm an assured option to acquire shares that would raise its stake to 21 per cent in Commerzbank, if approval to cross the 10 per cent holding barrier is received from the ECB. According to Reuters, Unicredit has said its exposure to Commerzbank had been hedged "to provide it with full flexibility" to either retain, sell or increase the stake further. Any settlement will occur after it receives permission to raise its holding to 29.9 per cent.

Meanwhile, there are signs that Unicredit is in contact with non-governmental shareholders of Commerzbank. A Commerzbank representative reportedly told the Financial Times that it had “taken note” of Unicredit’s move and that its boards were “always open to responsibly evaluating strategic options”, while keeping in mind the interests of all stakeholders — investors, employees and clients. That definitely appears to keep the door open, if the ECB relents.

As the story unfolds, a German government looking for resources to finance expenditures that can stimulate its economy without raising the deficit on its budget may see cause to sell its remaining stake at a negotiated price. Europe is in the midst of change, and this major step in that change may be difficult to stall. That would begin a process of restructuring of European banking that may not be in the best interests of small and middle businesses and ordinary depositors.

*** This article was originally published in The Frontline on September 29, 2024.**