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WHITEPAPER

Banks Navigating Global Crises: Analysis of Geopolitical Risks and their Impact on the Financial Sector

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1. Executive Summary

The era of complex international challenges—from trade conflicts to military tensions—continues to impact economies and financial institutions worldwide, creating a need for proactive risk management from banks. This white paper addresses the potential effects of recent changes and instability in China, the Middle East, and recent U.S. policy shifts following the 2024 election on German and European banks, focusing on credit, market, liquidity, business, sanctions, and cyber risks.

Analysis shows that Germany's economic dependency on China presents vulnerabilities, especially as heightened tensions over Taiwan and strained U.S.-China relations evolve. Overall, China remains Germany's largest source of imports (12% of total imports) and fourth-largest export market. A disruption of trade flows could significantly affect critical sectors like automotive, electronics, and renewable energy. Deutsche Bundesbank reports that German banks hold approximately €36 billion in direct credit exposure to Chinese entities, alongside €140 billion in indirect credit exposure tied to German companies that rely on exports to China, and €92 billion from companies exposed to Chinese imports of, for example, essential raw materials like rare earths. Another €220 billion in claims relates to German companies with significant investments in China, particularly in automotive and chemicals. These figures highlight the considerable trade and investment dependencies between Germany and China. Should these tensions further escalate, leading to sanctions or severe trade restrictions, several German industries may face supply chain challenges, potentially impacting borrower solvency and creditworthiness. Additionally, China's ambitions to lead in cyber capabilities by 2035—currently associated with 45% of cyberattacks on German firms—pose growing cyber risks for Western institutions.

In the Middle East, German banks have limited credit exposure to countries directly affected by conflict, such as Israel, Palestine, Iran, and Lebanon, due to longstanding instability and sanctions. By contrast, the Gulf states remain attractive markets for German banks through infrastructure projects like Saudi Arabia's „Vision 2030" and wealth or asset management opportunities. While

potential instability or stricter sanctions in the Middle East could pose challenges to these engagements, major systemically significant risk exposure for German financial institutions is not expected. Disruptions in the Gulf might impact German supply chains and energy access; however, Germany's dependence on Middle Eastern oil has already decreased to just 6-7% of total oil imports, mainly due to diversification and lower oil dependency.

The start of the Trump administration, has introduced a significant level of uncertainty for European financial institutions. With the U.S. expected to adopt a more protectionist trade stance, higher tariffsa – potentially up to 10% for Europe and 60% for China – may impact the creditworthiness of German firms reliant on U.S. exports and create new challenges in Europe's trade relationship with China. The U.S. is Germany's second-largest trading partner, and the Leibniz Institute for Economic Research estimates that a 15% decline in exports would lead to a GDP loss of €120–150 billion over four years. Additionally, a stronger U.S. dollar and potential interest rate hikes may elevate foreign exchange and interest rate risks for German banks with U.S.-denominated assets, adding to operational and compliance costs. Given the unpredictability often associated with Trump's policies, German institutions are encouraged to strengthen resilience against these potential disruptions.

To navigate this increasingly complex environment, financial institutions are advised to focus on scenario-based stress testing and employ quantitative assessments with sensitivity analyses to better gauge risk exposure. Strategies such as diversifying credit and market exposure, enhancing compliance and cybersecurity measures, and fostering active regulatory dialogue can support operational resilience and financial stability across the European financial system.

2. Introduction: Rising Uncertainty in the Geopolitical Landscape

Geopolitical instability escalates, creating complex risks for global economies

In today's interconnected global landscape, geopolitical instability presents a significant and growing challenge for economies and financial institutions alike. As multiple crises unfold simultaneously, long-standing geopolitical tensions have intensified, and new flashpoints continue to emerge, adding risk layers of complexity to the global order. From trade wars to military confrontations, today's environment is characterized by several conflict zones escalating simultaneously and is therefore marked by unpredictability. Those implications extend far beyond the borders of the countries directly involved.

> **S&P Definition (2023):** „Geopolitical risks can be understood as risks arising from interactions among countries. These interactions include trade relationships, security partnerships, alliances, multinational climate initiatives, supply chains, and territorial disputes [...] Examples of risks include cross-border or international conflicts, hybrid wars and cyber-attacks, de-dollarization dynamics, changing trade relationships, sovereign debt, and competition for minerals, which can negatively impact a company's cash flow and ability to meet its obligations."

European financial institutions particularly affected

For financial institutions, the interconnected nature of international trade, capital flows, and supply chains makes it nearly impossible to remain insulated from geopolitical shocks. For Europe and Germany in particular, having a highly globalized economy and financial system, these developments raise critical questions about how external risks may affect the domestic banking sector and broader European financial stability.

By analyzing the various direct and indirect risk types, including credit, market, liquidity, business, sanctions, and cyber risks, this white paper aims to assess how these crises and developments could affect the German financial sector. The goal is to provide insights for German and European financial institutions, enabling policymakers, bank executives, and risk managers to remain vigilant and develop robust strategies that can mitigate these risks and ensure resilience in the face of growing geopolitical uncertainty.

3. Methodology

To address the research question of how escalating geopolitical crises could impact the European financial sector, the following approach was adopted:

1. Map and prioritize global geopolitical conflicts potentially impacting the German and European financial system based on geopolitical proximity, trade dependencies, and escalation potential.

2. Develop four to five potential scenarios per region including one with further escalation and a general deterioration.

3. Focus first on the escalation scenario and analyze which risk types are negatively impacted and assess transmission channels and possible direct and indirect implications across key risk areas.

4. Use the German banking sector as an illustrative case study (given that Germany represents the largest European economy) to provide examples and quantify potential impacts as much as possible.

5. Derive applicable mitigation strategies for the German and European financial sector.

For our research we combined quantitative data from financial institutions' annual reports, financial statements, corporate publications, and Pillar 3 reports, as well as qualitative insights from publications by leading economic institutes, political organizations, and financial experts.

4. Scope and Limitations

Several geopolitical key conflict zones are of immediate concern: the ongoing Russia-Ukraine war, rising tensions involving China (including the Taiwan conflict and unrest in Hong Kong), the conflict between Israel and Hamas, and longstanding tensions with countries like Iran and North Korea. These crises are further compounded by Donald Trump's re-election as U.S. president, a shift that is likely to affect global trade policies and alliances.

Given the need to focus the analysis, a shortlist of key conflicts to examine was created based on factors explained in Step 1 of our methodology. Through this process, longstanding tensions with North Korea and Iran were excluded from the final analysis.

Additionally, while the Russia-Ukraine war is highly significant, it has reached a stage with extensive sanctions and adaptation measures already in place, limiting the potential for further risk assessment. For this reason, our final analysis concentrated on China, the Middle East, and the U.S., where geopolitical developments remain fluid and could have a more substantial and unpredictable impact on the European financial system.

European financial institutions have already largely reduced their exposure to Russia

5. Geopolitical Risks: China in Focus

The geopolitical tensions surrounding China have evolved over decades, presenting complex risks to global stability. One significant source of conflict is the unresolved situation with Taiwan, which has persisted since 1949, when the island separated from mainland China following the Chinese Civil War. While Taiwan functions as a de facto independent state, China continues to view it as a breakaway province, raising the risk of escalation, particularly as tensions with Western nations grow (BBC, 2024). Similarly, Hong Kong, returned to Chinese sovereignty in 1997 under the „One Country, Two Systems" framework, has seen its autonomy steadily erode, fueling domestic unrest and drawing international concern. Additionally, China's broader geopolitical risk profile is shaped by ongoing human rights issues, particularly regarding the Uyghur minority in Xinjiang, as well as its trade tensions with the United States.

Longstanding tension with Taiwan at risk of escalation

Looking ahead, the possibility of increased tensions between mainland China and Taiwan remains a concern. Any escalation in this area could prompt Western support for Taiwan, potentially resulting in economic and political sanctions against China that might impact key sectors like technology, finance, and trade. Hong Kong, as a financial hub closely linked to China, could also experience some collateral effects, contributing to regional uncertainty.

The effects of such heightened tensions could extend beyond the immediate region. Global supply chains, already under strain from existing geopolitical tensions and post-pandemic disruptions, may face further challenges. Additionally, German trade revenues, Western cybersecurity, and global financial relations may be affected, with implications for the German financial sector. This situation highlights the need for an in-depth analysis of potential types of risks.

5.1. Risk analysis: German Economy remains Reliant on Chinese Market

Direct Credit Risk

Direct credit risk refers to potential losses arising if borrowers in China cannot meet their financial obligations. For German banks, an escalation of the conflict could impact the creditworthiness of Chinese companies and institutions, causing delayed payments or defaults. This would directly affect the banks' balance sheets by increasing non-performing loans and requiring higher loan loss provisions.

According to estimates from the Deutsche Bundesbank, as of 2022, German banks held €36 billion in direct credit claims against Chinese entities, including €19 billion in on-balance sheet credit claims and €17 billion in derivatives and off-balance sheet transactions (Deutsche Bundesbank, 2022).

German banks held €36 billion in direct credit claims against Chinese entities in 2022

Indirect Credit Risk

Indirect credit risk arises from German companies with significant exposure to China through imports, exports, or direct investments. Supply chain disruptions, loss of key sales markets, or weaker business conditions for German companies operating in China could increase the default risk on domestic loans. This is particularly relevant given that China was Germany's largest trading partner annually from 2016 to 2023. Although trade volumes with China have declined over the past two years, and the United States is expected to surpass China as Germany's top trading partner in 2024, China remains a leading trade partner and largest source of imports for Germany, underscoring its critical role for the German economy (Statistisches Bundesamt, 2024).

China Germany's largest trading partner from 2016 to 2023

Indirect Credit Risk – Export Exposure

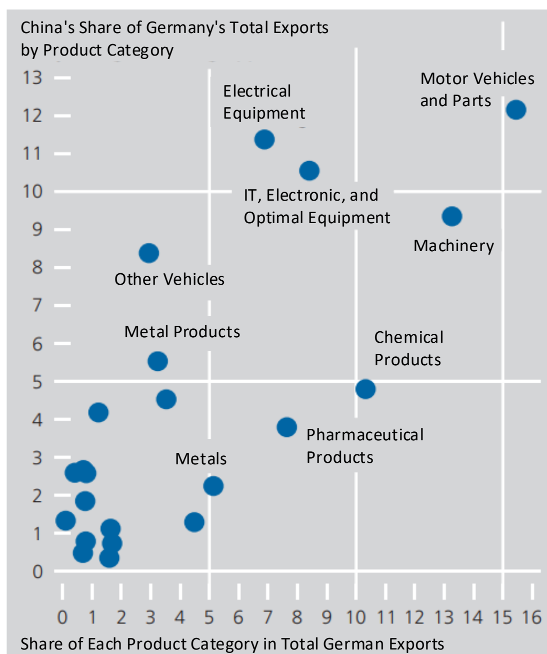
In 2023, German exports to China accounted for 6% (€97 billion) of total German exports, making China the fourth-largest export market for Germany (Statistisches Bundesamt, 2024). This trade volume equates to approximately 2.3% of German GDP (Statista, 2024). A disruption in trade flows due to an escalation in the China-Taiwan conflict or the imposition of sanctions might significantly affect the payment capacity of export-dependent German companies. Key industries, including automotive, mechanical and electrical engineering, chemicals, metallurgy, and electronics, are particularly vulnerable (Deutsche Bundesbank, 2022; Statistisches Bundesamt, 2024).

6% of German exports go to China, especially in automotive, mechanics, and chemicals

As of the end of 2022, German banks' total claims on companies in these sectors amounted to around €140 billion, representing 40% of core capital for an average systemically important bank (Deutsche Bundesbank, 2022). Should these industries experience a sharp decline in revenue due to reduced exports to China, this could significantly elevate the credit risk for most of German banks.

German banks claim €140 billion against export exposed companies

Figure 1: Overview of China's Importance for German export by product category 2023 (in %)



Source: Deutsche Bundesbank, Statistisches Bundesamt

Figure 2: Dependence of German DAX Corporations on China and Asia (share of total sales in %)

Data for Asia-Pacific and China (including Greater China)

Companies	Share of Revenue in Asia-Pacific	Of which China
Volkswagen	40,2	36,3
BMW	42,0	32,0
Infineon	58,0	32,0
Mercedes Benz	40,4	30,9
Porsche [1]	24,8	24,8
Covestro	32,7	21,0
adidas	26,0	15,0
BASF	25,4	14,0
Daimler Truck	26,0	13,0
Siemens Healthineers	26,9	13,0
Siemens	23,8	12,0
Continental	21,0	11,0
Sartorius	23,5	8,1
Bayer	17,6	8,0
Henkel	15,2	7,4

1 Asia Figure represents China revenue

Source: Germany Trade and Invest, based on company reports

Indirect Credit Risk – Import Dependency

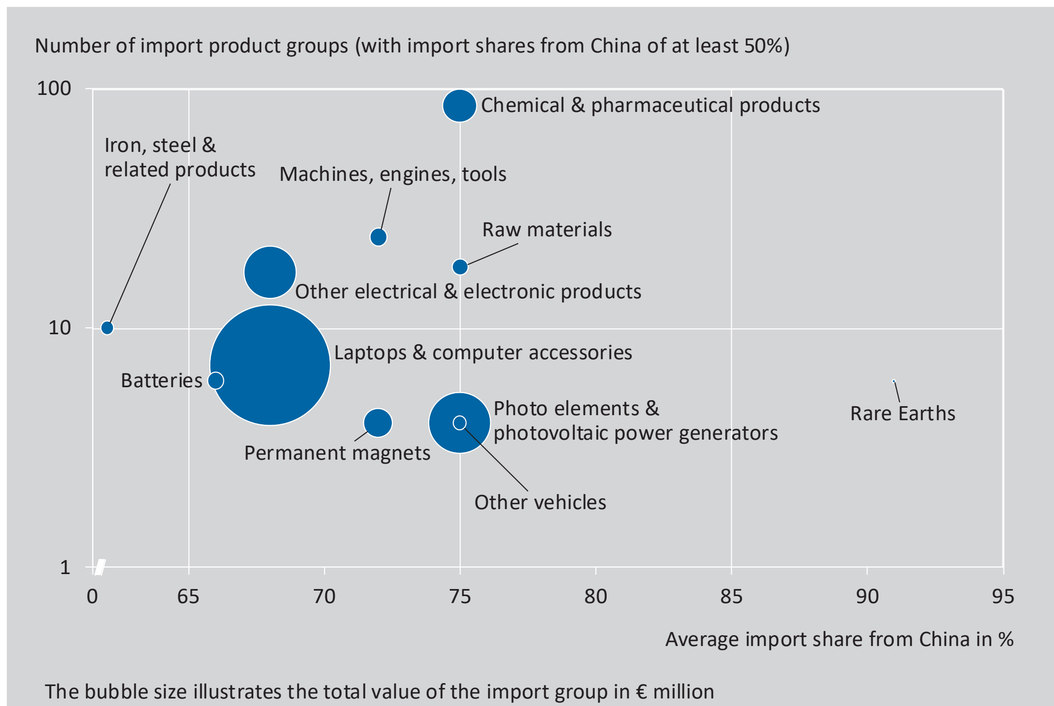
China is also Germany's largest supplier of goods, with 12% (€156 billion) of total German imports originating from China, accounting for approximately 3.7% of German GDP (Statistisches Bundesamt, 2023; Statista, 2024). Almost half of companies in the manufacturing sector rely on critical intermediate goods sourced either directly or indirectly from China, and 80% of these firms have stated that substitution would be difficult. In the event of a crisis or sanctions, disruptions in supply chains and production stoppages would be unavoidable, especially for productions reliant on Chinese imports (Institut für Wirtschaftsforschung, 2022). The greatest import dependencies (by € value) can be seen in electrical and electronic products, such as laptops, computer accessories, photo elements, photovoltaic power generators, batteries, and permanent magnets. Additionally, the German industry is highly dependent on certain chemical and pharmaceutical products that have very limited alternative suppliers outside of China. Another critical issue involves the dependence on critical raw materials and minerals from China. According to the European Commission, 97% of the magnesium used in Europe, and even 100% of certain critical strategic raw materials, such as rare earths, are sourced from China (Europäische Kommission, 2023).

12% of German imports from China, 80% of manufacturing companies say substitution would be difficult

Main goods are electrical and electronic products, pharmaceuticals, chemicals, and certain raw materials/minerals

In a 2023 analysis, the EU identified 34 critical raw materials, with China ranking among the top three producers for 27 of them (Germany Trade and Invest, 2024). These materials are essential for key technologies and the green energy transition, leading to the adoption of an EU Critical Raw Materials Act in 2024, aimed at promoting diversification and increasing autonomy within Europe. Further relevant imported goods that are significant for production facilities include vehicles, iron, and steel (Europäischer Rat, 2024, Leibniz Institut für WIrtschaftsforschung, 2022). As a result, the most vulnerable industries would be automotive, electronics, chemicals/pharmaceuticals, as well as renewable energy (Deutsche Bundesbank, 2024; Institut der Deutschen Wirtschaft, 2024; Kiel Institut für Weltwirtschaft, 2023).

Figure 3: Overview of China's German import dependency by product category 2023



Source: Statistisches Bundesamt, Institut der deutschen Wirtschaft

By the end of 2022, the banking sector had outstanding claims totaling €92 billion against companies in these industries, which represents roughly 25% of core capital of German systemically important banks, highlighting the potential financial risks for German banks should a supply chain breakdown occur (Deutsche Bundesbank, 2022).

German banks claim €92 billion against export exposed companies

Taiwan's Critical Role in the Global Economy: Focus on Semiconductor Production

"In our high-tech world, almost every electronic product contains a component from Taiwan," says Dirk Jandura, President of the German Wholesale and Foreign Trade Association (BGA, 2022). This statement highlights Taiwan's significant role in the global semiconductor supply chain, supporting essential industries like automotive, electronics, aerospace, 5G networks, and autonomous vehicles. In Germany, the automotive and electronics sectors are particularly reliant on these semiconductors.

Taiwan is home to Taiwan Semiconductor Manufacturing Company (TSMC), the world's largest semiconductor manufacturer, responsible for over 50% of global revenues from the top 10 semiconductor foundries. Taiwan controls 37% of global production capacity for logic semiconductors and 92% of advanced logic chips (≤7nm), crucial for modern electronics. The country also leads in semiconductor testing and assembly, with ASE as a global leader. TSMC and other Taiwanese firms supply nearly all major tech companies, including Apple, Nvidia, AMD. While South Korea also has significant chip production capabilities, even large players like Samsung and SK Hynix lag Taiwan in advanced logic chip manufacturing. In the U.S., companies like Intel play an important role but focus on chip design rather than manufacturing. This "fabless" model means U.S. firms rely on foundries in Taiwan, South Korea, or China for production (Europäische Kommission, 2024; Handelsblatt, 2022).

A military conflict or maritime blockade by China could severely impact chip shipments. Compounding this risk is the transport through the Taiwan Strait–a 180-kilometer-wide waterway that is one of the critical maritime routes for global trade, carrying not only semiconductors but also other essential goods like raw materials or electronics (Germany Trade and Invest, 2024). Given Taiwan's strategic importance, both the U.S. and Germany have expressed strong support for Taiwan, with Germany considering economic sanctions against China if tensions escalate. Legally, the Taiwan Relations Act of 1979 commits the U.S. to supporting Taiwan's defense, though it does not obligate direct military intervention.

Indirect Credit Risk – Foreign Direct Investment (FDI)

German companies have steadily increased their direct investments in China, particularly in sectors such as automotive, mechanical engineering, and chemicals, by investing in Chinese subsidiaries and production hubs. In fact, between 2021 and 2023, German firms invested as much in China as they had in the entire six-year period from 2015 to 2020, with €11.9 billion invested in 2023 alone, highlighting the continued strategic importance of China for German businesses (Institut der Deutschen Wirtschaft, 2024). The revenues generated by Chinese subsidiaries of German corporations amounted to €382 billion in 2023, with €23 billion in profits—equivalent to 22% of global revenues and 15% of global investment income from German

German FDI in China increase exponentially year by year with €382 billion of revenues generated by Chinese subsidiaries in 2023

direct investments (Deutsche Bundesbank, 2024). However, this also exposes German banks to a significant degree of indirect credit risk.

German banks hold €220 billion in claims against companies with substantial exposure to China through foreign direct investment. This figure represents almost 7% of the risk-weighted assets of German banks and 42% of CET1 capital, particularly in significant institutions (Deutsche Bundesbank, 2024). If tensions or sanctions escalate, these investments could face increased risk, impacting some of Germany's largest DAX companies and their creditworthiness.

German banks claim €220 billion against FDI exposed companies

Market Risk

Market risk encompassed potential losses from shifts in interest rates, equity prices, exchange rates, or commodities. While an escalation in the China conflict might trigger global market volatility, the direct exposure of German banks to market risks tied to China is not expected to be as substantial compared to the impact market fluctuations in other regions like the United States would have.

Low market risk expected due to minimal investments in Chinese corporate bonds, low currency exposure and few commodity trades

While market risks like equity risk, foreign exchange risk, and commodity risk are always present, they are somewhat limited in the case of China, according to various banks' Pillar 3 reports. This is because German banks' investments in Chinese corporate bonds are minimal, and their primary currency exposures remain focused on the euro and U.S. dollar rather than the Chinese yuan.

Similarly, commodity risk, particularly price volatility in raw materials and derivatives, poses little threat. This is because since the financial crisis, stricter regulations like Basel III have led banks to primarily trade commodity derivatives on behalf of clients rather than holding significant positions themselves.

The most relevant market risk here is interest rate risk. An escalation in the China conflict could lead central banks to lower interest rates to counter potential economic disruption (Deutsche Bundesbank, 2024). While the exact impact is difficult to predict, such a rate cut would aim at stimulating the economy. For most German banks, this would likely have a positive effect by reducing borrowing costs and supporting economic activity, therefore not posing a major risk.

Escalation in China likely to lower European interest rates

Business Risk

Business risk refers to potential losses that could occur if parts of a banking group or operations in a crisis region need to write down assets or if income from local business declines while costs continue to accrue. In addition, when significant portions of the value chain are located in the crisis region, strategic and financial risks may increase.

Financial reports indicate that German banks' equity and value creation share in China is low

Capital risk, though part of business risk, is not expected to be substantial in this scenario. While potential write-downs or continued operational costs (e.g., asset seizures or ongoing property expenses) are possible, the overall impact is likely to be minimal. Financial reports indicate that only a small proportion of German banks' equity is tied up in China, lowering the likelihood of significant capital losses. That said, business risk remains relevant as German banks generate revenue in China and could experience a revenue decline. While the exact impact varies by institution, financial disclosures show that the share of revenue from China is not large enough to trigger substantial sector-wide business risks. Furthermore, the value chain reveals limited integration between Germany and China, with relatively few full-time employees in Chinese subsidiaries. An exception are booking centers in Hong Kong, used for legal processing and

Main business risk are banks' booking centers in Hong Kong

accounting, including for business outside China. Relocating these centers to locations like Singapore is possible but would involve administrative and cost burdens that would affect banks differently. The Russia-Ukraine conflict provides a useful comparison: While Deutsche Bank with around 1,500 critical IT and software staff in Russia supporting global systems had to quickly relocate operations to protect key know-how (Handelsblatt, 2022), such relocations are unlikely to be needed in China, apart from potential risks to booking centers.

A potential but unlikely development is an increase in capital requirements for operational risk, stemming from disruptions caused by the conflict. Operational risk capital is calculated based on historical loss data and scenario-based forecasts and given the limited exposure of German banks to China, a substantial rise in capital requirements is not anticipated.

Liquidity Risk

Liquidity risk arises when financial institutions lack sufficient liquid assets to meet their financial obligations. In the event of a crisis, German banks may face heightened liquidity pressures, as companies with significant exposure to China are likely to draw more extensively on their unused credit lines. While German banks are not materially dependent on Chinese funding, these increased liquidity demands could place additional strain on their reserves. However, the precise impact remains uncertain due to the lack of clear data on the volume of untapped credit facilities within the German banking system but is likely not material enough to pose a threat to the overall liquidity situation of German bank.

Companies drawing extensively on their credit lines could increase banks' liquidity pressure

Sanction Risk

Sanction risk encompasses the financial, legal, and reputational challenges that arise from the imposition of sanctions and Anti-Money Laundering (AML) regulations. In the event of an escalation involving China, sanctions are likely and could resemble the comprehensive measures currently imposed on Russia. Financial sanctions tend to be broad, complex, and highly volatile; non-compliance—whether through errors or delays—can result in significant financial penalties, legal consequences, and reputational damage. Under German law, violations of sanctions as defined by the Foreign Trade and Payments Act (AWG) and the Foreign Trade and Payments Ordinance (AWV) may be prosecuted as administrative offenses or, in certain cases, as criminal offenses (Deutsche Bundesbank, 2024).

Sanctions similar to Russia in case of escalation likely – non-compliance brings financial & reputational risk

Although the risk posed by sanctions is significant, the extent of its impact varies widely and is difficult to quantify. The severity of the consequences depends on the specific nature of the sanctions and how effectively financial institutions manage their compliance processes. Historical examples, such as the reputational damage faced by German banks for not immediately withdrawing from Russia, highlight the potential for negative public perception (Tagesschau, 2024). Additionally, financial risks can arise from retaliatory actions, such as the confiscation of German bank assets by the Russian judiciary in response to Western sanctions (Manager Magazin, 2024). Similar scenarios could unfold with China, making sanction risk a critical area of focus for German banks.

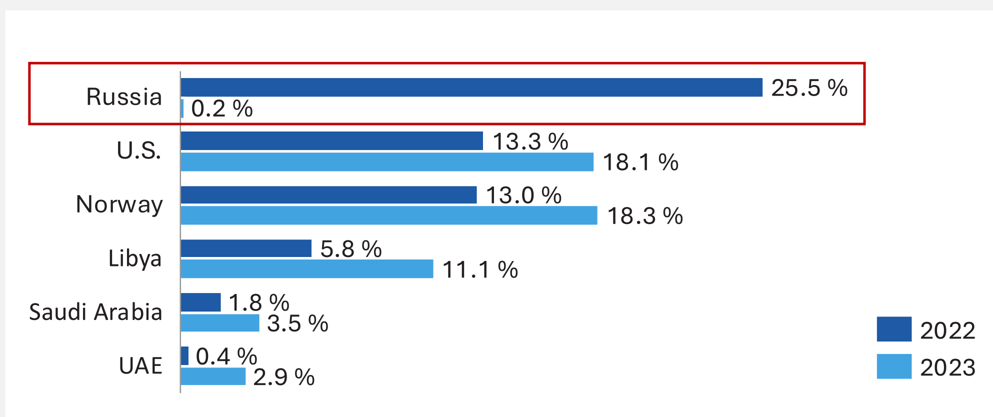
Economic and Political Sanctions:
EU's Response to the Russia-Ukraine War

In response to the Ukraine conflict, the EU and its international partners have imposed extensive sanctions on Russia, targeting both individuals and Russian assets as well as trade activities.

Individual sanctions include travel bans and the freezing of assets of 2.300 Russian nationals, including politicians and oligarchs. Approximately €24.9 billion in private assets have been frozen within the EU.

In addition, economic sanctions include measures such as excluding Russian banks from the SWIFT system, freezing central bank reserves worth around €210 billion, and enforcing extensive transport and trade restrictions. These trade restrictions have reduced the value of exports to Russia by €48 billion and imports from Russia by €91.2 billion, including a comprehensive ban on Russian oil imports affecting about 90% of Russian oil entering the EU (Europäischer Rat, 2024).

Figure 4: Shares of selected countries in the German import volume of crude oil in 2022 and 2023



Source: Statistisches Bundesamt

The aim of these sanctions is to exert economic and political pressure on Russia and to limit its capacity to wage war. Similar sanctions could be applied to other countries in the event of geopolitical tensions. For financial institutions, these sanctions result in increased compliance requirements and operational risks, especially regarding the enforcement of sanctions and the management of frozen assets.

Cyber Risk

China has become a leading cyber power

Cyber risk has emerged as a critical threat to the financial sector, with German banks increasingly targeted by phishing, ransomware, and hacking attacks that jeopardize operating systems and financial data.

Numerous case studies and examples indicate that China is actively building and deploying cyberattack capabilities to advance its core national interests. This increasing confidence is reflected in Chinese military documents: China's 2015 military strategy framed the nation as a "major victim of cyberattacks," justifying the urgent development of a dedicated "cyber force". By 2019, China's national defense boldly described the country as a "major cyber country" with the ambition to become the world's leading cyber power by 2035 (The State Council, 2015, 2017&2019; Booz Allen, 2022).

In this context, state-sponsored cyber espionage from China represents a growing threat, with Chinese groups like APT10, responsible for the Cloud Hopper campaign, targeting Managed Service Providers (MSPs) to steal sensitive data and intellectual property (Forbes, 2023). China's extensive resources and sophisticated technical capabilities fuel continuous investments in hacker training and cyber warfare, resources it is likely to leverage as geopolitical tensions rise. Indirect cyberattacks on third-party countries, such as the 2022 cyberattack on Ukrainian satellite services that disrupted wind farms across Europe, underscore the risks of supply chain vulnerabilities. Direct attacks on the German financial sector are also expected to intensify, especially if tensions or sanctions against China increase.

State-sponsored espionage and cyber warfare investments increase continuously

According to the Bitkom economic protection study, sabotage, espionage, and data theft caused German companies an annual loss of €267 billion in 2023, with approximately €179 billion attributed to cyberattacks – a 29% increase from the previous year. Notably, 45% of these attacks originated from China. Data theft and industrial sabotage remain pressing concerns, affecting 81% of companies, while 65% of businesses now view cyberattacks as an existential threat to their business. Furthermore, 69% of companies believe that the threat of cyberattacks has increased as a result of the numerous global conflicts and wars (Bitkom, 2024; Bundesamt für Verfassungsschutz, 2024).

€267 billion loss in 2023 due to cyberattacks of which 45% stem from Chinese attacks

Looking ahead, the Global Cybersecurity Outlook Report 2023 reveals that 93% of cyber leaders and 86% of business leaders think it is "moderately" or „very" likely that global geopolitical instability will „lead to a far-reaching, catastrophic cyber event in the next two years" (World Economic Forum, 2023). Their top concerns include business continuity (67%) and reputational damage (65%), both of which could be severely affected if cyberattacks intensify amid geopolitical conflict with China (World Economic Forum, 2023).

69% of companies believe that the threat of cyberattacks has increased due to global conflicts

6. Geopolitical Risks: Middle East in Focus

The Middle East conflict is deeply rooted in complex historical, political, and religious tensions, with direct involvement from Israel, Palestine, Iran, and Lebanon. This longstanding struggle has its origins in the early 20th century and the establishment of Israel in 1948, which triggered regional opposition and a series of wars, shaping the modern geopolitical landscape. The Israeli-Palestinian conflict, coupled with Iran's adversarial stance toward Israel, has intensified divisions, while Lebanon's internal dynamics further complicate regional stability (Council on Foreign Relations, 2024).

In addition to these primary actors, neighboring countries such as Egypt, Jordan, and influential Gulf states, including Saudi Arabia and the UAE, also play crucial roles. They influence the conflict's direction through alliances, diplomatic efforts, and, in some cases, mediation roles. The Gulf states' wealth and strategic partnerships, often aligned with Western interests, add an economic dimension that shapes international policies toward the region (Landeszenrale für polititsche Bildung BW, 2024). These interconnected dynamics create ongoing risks that reverberate globally, impacting energy markets, trade, and security considerations for financial institutions with interests in the Middle East.

Besides directly involved countries, several Gulf states are crucial in the Middle East conflict

6.1. Risk analysis: Germany's Limited Vulnerability to Middle East Escalation

Credit Risk
Direct Credit Risk

The direct credit exposure of German financial institutions to countries directly involved in the Middle East conflict—namely Israel, Palestine, and Lebanon—remains limited. Further, Credit exposure to Iran has been minimal for years due to strict sanctions, effectively restricting significant lending activities in the market.

Credit risk mainly from project financing, investment banking, and asset management in wealthy Gulf states

However, exposure to the Gulf states, particularly the UAE, Saudi Arabia, and Qatar, is considerably higher, driven by financing for large infrastructure projects, renewable energy initiatives, investment banking, and asset management services. One such example is Saudi Arabia's „Vision 2030" project, which aims to diversify its economy by boosting tourism, culture, and entertainment sectors, but relies on regional stability (LSEG, 2024). Escalation of the Middle East conflict could thus pose a risk to these ventures.

Moreover, wealth and asset management services are essential in these affluent Gulf states, supporting both high-net-worth private clients and sovereign wealth funds. Given the potential for these countries to be drawn into the conflict, an associated credit risk cannot be entirely ruled out (for more see business risk).

Indirect Credit Risk

No major export-dependencies with the Middle East

The indirect credit risk for German financial institutions linked to export-dependent companies is currently limited, as trade with directly involved countries, such as Israel, remains modest. Exports to Israel accounted for just 0.4% of Germany's total exports in 2022, with primary goods being vehicles, machinery, and pharmaceuticals. Although Germany maintains collaborative projects in sectors like cybersecurity and medical research with Israel, these are unlikely to materially impact overall financial exposures even if temporarily paused. In contrast, Germany's trade ties with Gulf states are more substantial, particularly with Saudi Arabia, the UAE, and Qatar. For example, the upcoming LNG supply agreement with Qatar starting in 2026 represents a key commercial connection (Institut der deutschen Wirtschaft, 2024). However, given the resilience and diversity of the Gulf economies, potential disruptions due to conflict in the region are not expected to substantially affect German banks' credit exposure to export-oriented companies.

Historical Development of the Oil Market and the Role of the Gulf States

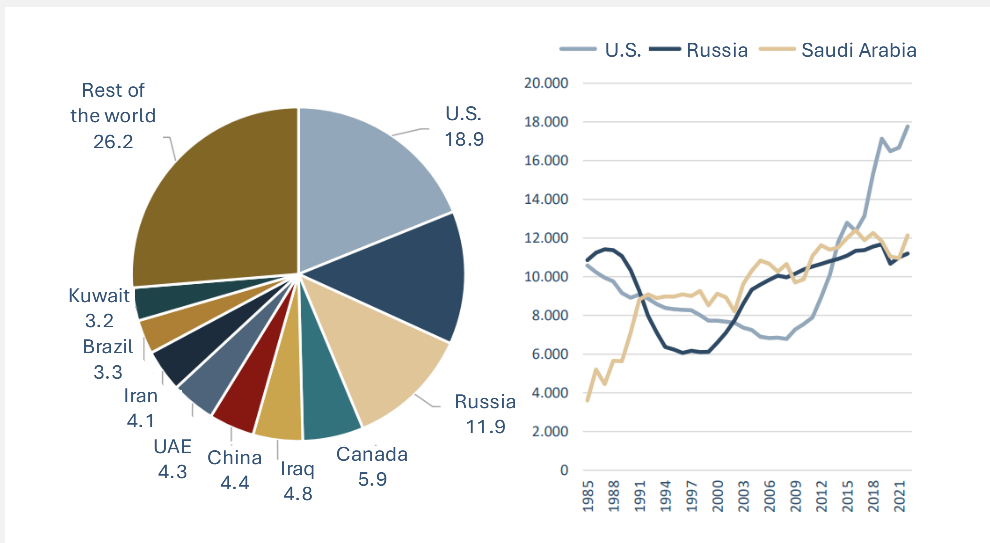
In the 1970s, the Gulf states were central suppliers to the global oil market and played a key role in the first major oil crises. The 1973 Yom Kippur War and the ensuing OPEC oil embargo against Western countries led to massive price spikes, exposing the vulnerability of Western economies, which were then highly dependent on Gulf oil.

Since then, global reliance on Middle Eastern oil has declined significantly due to technological advances, the rise of renewable energy, and strategic oil reserves. The oil intensity of economies—oil consumption per unit of production—has decreased by about 40–50% in the U.S. and Germany since the 1970s. The U.S. fracking revolution, starting in the 2000s, was a major turning point, making the U.S. the world's largest oil producer by 2014 and sharply reducing its import needs, which transformed the global oil market.

Today, the Gulf states remain important oil suppliers; in 2022, about one-third of global oil production came from Saudi Arabia, the UAE, and other Gulf nations. While a blockade of the Strait of Hormuz or an escalation in the Middle East could lead to supply shortages and price increases, the risk of a severe oil shock, as seen in the 1970s, is now much lower due to greater market diversification and alternative energy sources. The primary buyers of Gulf oil are now Asian countries, such as China and India, which are part of the BRICS agreement (Institut der deutschen Wirtschaft, 2024).

Figure 5: Largest crude oil producers worldwide

Percentage share of global production (in thousands of barrels per day) in 2022



Source: BP, 2023; Institut der deutschen Wirtschaft, 2024

On the import side, Germany remains heavily reliant on oil imports, particularly for transport fuel, where over 94% of energy needs are met by mineral oil products. This dependency extends beyond transportation, with oil also essential for heating and as a raw material in industries producing plastics, pharmaceuticals, cosmetics, and textiles (Institut der deutschen Wirtschaft, 2024). However, oil imports from the Middle East have declined substantially over the years, now accounting for only about 6-7% of total oil imports, which reduces the potential

Germany much less dependent on oil from the Middle East (6-7%) than in the past

impact of Middle Eastern disruptions on German industries (Statista, 2024). While recent incidents, such as Houthi rebel attacks on cargo in the Gulf of Aden, reveal regional supply chain vulnerabilities, the limited reliance on Middle Eastern oil supplies means that import-related indirect credit risks for German financial institutions remain moderately low.

Market Risk

German financial institutions' market risk from Middle East instability remains largely contained. Like in the China context, direct commodity risk is minimal as banks primarily manage rather than hold commodities on their balance sheets.

Interest rate risk could emerge if rates in Germany adjust unexpectedly due to the conflict. However, this risk would only materialize if rate shifts deviated significantly from bank forecasts – an unlikely scenario based on recent stress tests and financial disclosures that indicate preparedness. Additionally, equity and foreign exchange risks related to the Middle East are limited, ensuring that overall market risk exposure for German banks remains modest.

Business Risk

Asset and wealth management possibly affected, but risk is not substantial

Business risk in countries directly involved in the conflict, such as Israel, Lebanon, Palestine, and Iran, remains minimal for German financial institutions, as wealth management activities in these regions are limited due to ongoing instability and existing sanctions. In contrast, Gulf countries like the UAE, Saudi Arabia, and Qatar might be affected more as they remain attractive asset and wealth management markets for large German banks who are serving both, affluent private clients and, in some cases, sovereign wealth funds. In these markets, institutions face two primary risks associated with their asset holdings. First, should assets currently managed by German banks in the Middle East require relocation due to regional instability or additional sanctions, banks would incur increased administrative costs and management expenses. While this would lead to higher operational costs, it is not expected to cause significant financial loss. Second, a more impactful risk would arise if escalating conflicts or sanctions led to the loss of certain Arab clients altogether, resulting in a direct loss of management fees. However, even in this case, given the relatively small share of these fees in major German banks' total revenues, this risk remains limited.

Capital risk from direct exposure to material assets or equity holdings in conflict zones is also not substantial. An operational risk exists in the UAE, which hosts one of the largest booking centers for German banks in the region. If severe escalation or broad sanctions required relocating this center, additional costs and administrative expenses would be incurred. Nevertheless, the likelihood of such extensive sanctions is low, keeping the overall risk at a moderate level.

Liquidity Risk

Liquidity risk for German financial institutions is minimal regarding the Middle East conflict. Given that funding and liquidity sources for these institutions are not closely tied to the region, disruptions are unlikely to impact stability.

Sanction Risk

Sanction risk for German financial institutions could arise if Western countries impose new sanctions on key financial centers like the UAE, limiting financial flows and complicating investment activities. Such measures would increase compliance requirements, making transactions

more costly and operationally complex. Non-compliance could result in severe reputational damage and legal risks, further heightening the importance of robust sanction adherence. However, extensive U.S. sanctions against Gulf financial hubs remain unlikely, given the economic and diplomatic ties involved and the historically generally positive stance of Trump's administration toward the Gulf states.

Sanction and Cyber risk is limited

Cyber Risk

Cyber risk for German financial institutions from the Middle East conflict remains low. Although Iran and Israel have engaged in extensive cyberattacks, these are largely contained within the region and are unlikely to have substantial global impacts. However, heightened vigilance is advisable given the potential for indirect threats during periods of increased geopolitical tension.

7. Geopolitical Risks: Start of the Trump administration

The U.S. election, resulting in a Donald Trump victory against Kamala Harris, signals a shift in American political and economic policy that introduces significant uncertainties for European and German financial institutions. Trump's prior administration was characterized by aggressive deregulation, unilateral tax reforms, and a protectionist trade agenda, which collectively altered the regulatory and economic landscape for foreign banks with U.S. ties. With a renewed mandate, Trump's administration is expected to intensify these U.S.-centric policies, potentially complicating cross-border financial operations. This evolving environment presents direct and indirect challenges for European banks, raising concerns over regulatory divergence, market volatility, and the stability of transatlantic economic relations.

With the Trump election large American policy shifts are anticipated, increasing uncertainty

7.1. Risk analysis: Trump Election might Endanger German Financial Institutions

Credit Risk

Direct Credit Risk

The direct credit risk of German banks toward the United States in itself is significant, as the U.S. is a key borrower and trade partner. German banks hold substantial credit exposures in the U.S., including financing, trade transactions, commercial real estate loans, and investments in American companies and assets. The stability of this credit risk is heavily influenced by the creditworthiness of the U.S. and the economic health of American businesses. Key factors affecting this risk include the Federal Reserve's interest rate policies, the broader U.S. economic outlook, and potential regulatory changes.

German banks hold substantial credit exposures in the U.S., risk heavily influences by economic health of the U.S.

A second Trump administration could impact this risk profile. Trump's deregulatory stance, such as lowering capital requirements for banks, might temporarily benefit German banks with U.S. exposure by improving their profit margins and lending capacity. Trump's economic policies – such as potential tariff increases and other protectionist measuress – however, could introduce greater market volatility (Risk Management Association, 2024). These developments may introduce a degree of uncertainty, potentially impacting the repayment capacity of specific U.S. borrowers affected by policy shifts or market fluctuations. As a result, credit risk for German banks could modestly increase. Nonetheless, systemic defaults remain unlikely, given Trump's stated commitment to stimulating the U.S. economy and averting large-scale defaults at all costs.

Indirect Credit Risk

Under a Trump administration, geopolitical dynamics are likely to become more unstable and unpredictable, impacting major regions in different ways.

In Eastern Europe, reduced U.S. support for Ukraine or a tacit acceptance of current territorial divisions could boost Russian influence, potentially destabilizing NATO-aligned countries with Russian-speaking populations. This could embolden Russian efforts to destabilize the region e.g. through cyberattacks or targeted assaults on critical infrastructure, increasing risks for German banks with exposure in affected sectors and regions.

Trump likely to reduce Ukraine support and NATO commitment

Regarding Europe, a Trump administration might reconsider the U.S. commitment to NATO, potentially reducing the U.S. military presence in Europe. Such a shift could unsettle European foreign policy and indirectly impact financial stability (LBBW, 2024). Additionally, heightened U.S.-China tensions could lead to economic decoupling and significant tariffs on Chinese imports, potentially reaching 60%. This development could increase the pressure on Europe, a close U.S. ally, to align with U.S. policies. This however may risk disruptions in Europe's access to critical Chinese raw materials and strain the China-Germany relationship.

Increasing U.S.-China tensions might also impact EU-China trade

In the Middle East, there is an increased risk of confrontation with Iran under a Trump administration, potentially escalating regional tensions and impacting oil and gold prices. The direction of these price movements would depend on policy responses, highlighting the market volatility and uncertainty tied to these geopolitical shifts (LBBW, 2024).

These shifts under a Trump administration impact not only political stability but also international trade and the global economy. Rising tensions and shifting alliances could disrupt trade flows, tariffs, and supply chains, with significant effects on economic performance and financial stability. This is especially relevant for Europe and Germany, whose close trade ties with both the U.S. and China.

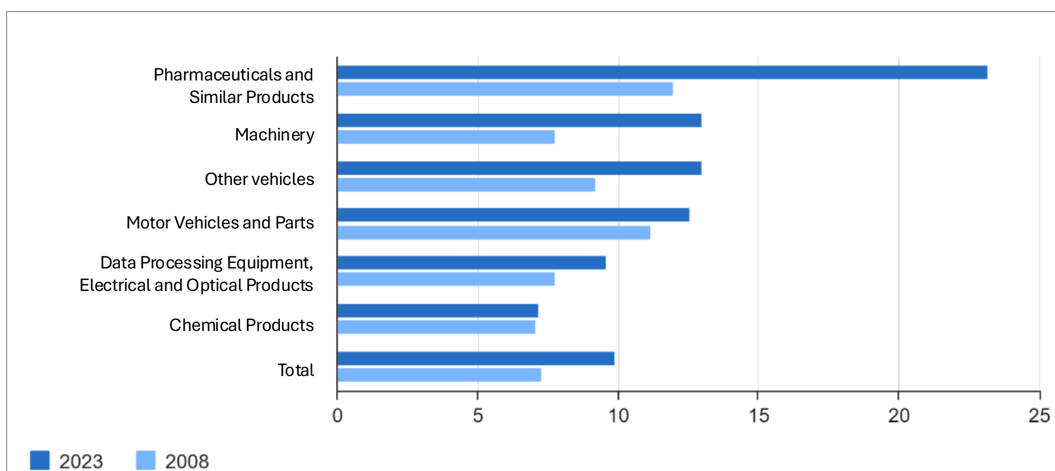
More specifically, the United States is Germany's second most important trading partner after China and, for the ninth consecutive year, was the largest foreign market for German exports, making up nearly 10% in 2023 – the highest level in over 20 years. The Eurozone posted a U.S. trade surplus of €135 billion in 2023, with Germany alone contributing around €63 billion to this figure.

U.S. largest foreign market for German exports for the 9th consecutive year

This substantial surplus could subject Germany to renewed scrutiny under the new Trump administration, which may bring back tariffs similar to those imposed in 2016. High-risk sectors include automotive and chemicals, both of which rely heavily on U.S. exports and may face stiffer competition from U.S.-subsidized firms. Further pressure on European firms to relocate parts of their production to the U.S. would add operational costs and complexity, while smaller German firms without U.S.-based production options remain particularly exposed to these shifts (Statistisches Bundesamt, 2024; LBBW, 2024).

High risk of increased tariffs for automotive and chemicals

Figure 6: Shares of U.S. Exports in Germay's Key Export Sectors (in %)



Source: Statistisches Bundesamt

Regarding imports, the U.S. is also Germany's third-largest supplier, accounting for 7% of all imports and serving as the second-largest oil provider. Key imports include cars, pharmaceuticals, crude oil, petroleum products, and engines (Statistisches Bundesamt, 2024). Even though the EU could potentially respond to U.S. trade policies with tariffs as well, leading to increased political tensions, major supply chain disruptions are less likely due to the United States' interest to continue export and Germany's options for alternative imports.

Imports unlikely to decrease substantially

Apart from the 90% of German companies that maintain both import and export ties with the U.S., around 12% of Germany's 39,000 foreign-controlled companies are U.S.-owned. The tightly interwoven transatlantic supply chain adds complexity and risk for German banks, with the U.S. remaining a significant factor in indirect credit risk even with post-COVID diversification efforts. According to the Leibniz Institute for Economic Research, a 15% drop in German exports could lead to a €120–150 billion GDP loss over four years, highlighting Germany's export dependency and the broader economic impact on German companies and their creditworthiness (Leibniz-Institut für Wirtschaftsforschung, 2024; Institut der deutschen Wirtschaft, 2024).

A 15% drop in German U.S. exports could lead to €120–150 billion GDP loss over four years

Market Risk

Trump's policies are expected to lead to a significant appreciation of the U.S. dollar, driven by a focus on stimulating domestic economic growth, prioritizing U.S. production, and introducing tax reductions for American businesses. Global political uncertainties may further increase demand for the dollar as a "safe haven" currency, while anticipated U.S. interest rate hikes to offset inflation would attract additional capital to U.S. markets (LBBW, 2024). This projected dollar appreciation carries notable implications for both the global economy and the German banking sector.

USD appreciation expected, increase in interest rates as a result likely

In terms of interest rate and foreign exchange risk, large German banks are expected to face increased risk due to U.S. monetary policy, as they rely on U.S. capital markets for funding. Rising U.S. inflation is likely to prompt the Federal Reserve to increase interest rates, raising the cost of U.S.-dollar-denominated loans and refinancing for these banks. Meanwhile, the appreciation of the dollar equally increases the costs due to more expensive exchange rates. Europe is anticipated to respond with rate cuts to counter deflationary pressures. Although such rate cuts are designed to ease the European economy, they may help offset some interest rate risk for German banks by supporting borrowing conditions domestically. However, to manage any volatility in funding costs stemming from U.S. rate increases, German banks may have to invest more in hedging strategies, adding complexity and expenses during periods of high interest rate volatility.

U.S. borrowing anticipated to become more costly

Geopolitical changes may further increase commodity risk due to expected price fluctuations in oil, gas, and gold driven by geopolitical changes. While this could affect banks' clients, German banks are largely insulated, as they mainly operate as intermediaries in commodity trading rather than holding direct investments.

Business Risk

Business and capital risks for German Banks in the U.S. are unlikely to be significantly affected by the Trump election, as assets and operations are expected to continue without major disruption. Regardless of potential regulatory or policy shifts, German banks' U.S. operations and investments should remain stable, as core banking functions are not expected to face restrictions or losses that would impact their continuity.

Liquidity Risk

German banks' reliance on U.S.-dollar-denominated funding creates liquidity and funding access risk, as changes in U.S. economic cycles and geopolitical developments can impact their access to dollar funding. For these banks, stable access to U.S. capital markets is essential for liquidity but shifts in U.S. monetary or geopolitical policies could limit dollar availability, making funding access more unpredictable. This risk is heightened during periods of dollar fluctuation, as restricted dollar access can complicate liquidity management by limiting capital flows, making it harder for banks to maintain stable liquidity positions.

Access to U.S. capital markets essential for liquidity – shifts in U.S. monetary policies could limit dollar availability and funding

Sanction Risk

Direct sanction risk related to the U.S. is minimal for German banks, given the strong alliance between Germany and the U.S., making sanctions highly unlikely. However, stricter U.S. sanctions on countries like China or Palestine under the Trump administration could require European alignment and adoption, potentially introducing further compliance or operational risks.

Cyber Risk

Cyber risk remains a relevant consideration for German banks, with potential for increased activity as threat actors may feel emboldened under a Trump administration. However, given the close U.S.-Germany alliance, a significant rise in exposure is not anticipated.

8. Strengthening Resilience: Recommendations for Managing Geopolitical Risks

To strengthen resilience against geopolitical risks, financial institutions should establish a comprehensive, modern risk framework that explicitly integrates geopolitical factors as key drivers. This requires not only a detailed description but also a mapping of all relevant risk types and their impacts, considering, among other factors, supply chains, transaction data, customer relationships, and sales markets in high-risk regions. Institutions should employ concrete scenario planning for geopolitical developments to proactively assess vulnerabilities and analyze the implications. Sensitivity analyses and, as much as possible, quantitative risk assessments will allow banks to understand the potential impact of these risks in depth.

Scenario planning, sensitivity analyses, and quantitative risk assessments are indispensable for managing geopolitical risks

Based on these assessments, each institution should derive customized mitigation measures according to its international exposure and client base. Key actions include limiting and actively managing credit exposure (according to stress test results), diversifying market exposure, enhancing supply chain resilience by relocating operations away from crisis zones, implementing scenario-based stress tests, strengthening compliance through advanced monitoring systems, and bolstering cybersecurity with incident response plans and regular audits.

Key mitigation measures are to actively manage credit and diversify market exposure, enhance supply chain resilience, and increase stress tests, compliance, and cyber security

From a regulatory perspective, authorities can support banks by facilitating dialogue and information exchange with international bodies, fostering timely sharing of insights on emerging geopolitical risks. Regulatory frameworks should integrate geopolitical risk into stress testing, encouraging banks to prepare for scenarios like trade disruptions or regional conflicts. Developing a refined risk landscape allows regulators to tailor requirements based on whether banks operate globally or nationally, ensuring more targeted risk management. Finally, consolidating stress test results across institutions will provide industry-wide insights, allowing authorities to detect systemic vulnerabilities and set guidelines that incorporate external geopolitical data, enhancing banks' ability to respond to complex international risks.

9. Conclusion

In an era of growing geopolitical complexity, German and European financial institutions are navigating a more challenging risk landscape, with important implications for banking operations, credit exposure, and strategic decision-making. This white paper has outlined key areas of concern affecting the sector, including developments in China and Taiwan, ongoing dynamics in the Middle East, and potential policy shifts stemming from the recent U.S. election. Each presents a distinct set of direct and indirect risks, influencing credit and market risk, liquidity, sanctions compliance, and cybersecurity.

Our analysis suggests that China's geopolitical positioning, coupled with trade dependencies and reliance on critical resources, introduces indirect credit risks for German banks. Heightened tensions around China-Taiwan relations or disruptions in trade flows could impact supply chains, borrower solvency, and the creditworthiness of clients in export-dependent industries. Developments in the Middle East, particularly regarding energy security and trade route stability, pose moderate risks for German banks, with some indirect impacts on oil price volatility and related sectors.

The new Trump administration adds another layer of uncertainty, with a potential shift toward protectionist and U.S.-focused economic policies. For German banks with significant U.S. exposure, this could result in currency fluctuations, changes in interest rates, and potentially higher operational and compliance costs. Trump's policies may also influence transatlantic trade dynamics, creating considerations for German clients with substantial U.S. dependencies, particularly in the automotive and chemical sectors.

To prepare for these evolving challenges, financial institutions are encouraged to adopt a structured risk management framework that emphasizes scenario planning and sensitivity analysis, enabling a deeper understanding of exposure across geopolitical scenarios. Regulatory authorities also play a critical role in strengthening resilience by enhancing risk-based oversight and promoting cross-border information sharing. As geopolitical uncertainties persist, robust risk management practices and proactive strategies will be essential to maintain stability and support the resilience of the European financial system in an unpredictable global environment.

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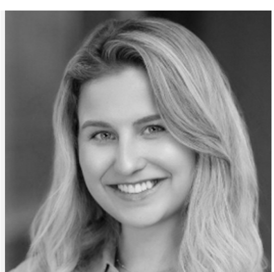

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