Like plane-crash survivors forced to eat their fellow passengers, investment bankers have found some sources of nourishment amid the wreckage of the banking industry. Helping weakened institutions to raise capital has produced a useful stream of fees. Goldman Sachs, a tediously successful investment bank, notched up a 72% increase in equity-underwriting revenues in the second quarter, much of it from other banks. But many have their eyes on an even bigger prize: the wave of M&A deals that is expected, eventually, to result from the credit crisis.

That a big shake-out is coming is in little doubt. Weaknesses in funding and business models have been laid horribly bare. Some franchises were too focused on the wrong markets. Wachovia, America’s fourth-largest bank, has suffered from outsize exposure to California’s imploding housing market and is a potential takeover target. Others face regulations that threaten their profits. The Wall Street banks are bracing for tougher capital and liquidity requirements as the price for access to the balance sheet of the Federal Reserve. Others still are questioning whether they have the right mix of businesses. The integration of volatile investment banking and staid wealth management at UBS and Credit Suisse, two Swiss banks, is the subject of much alpine soul-searching. Allianz, a German insurer, has apparently lost patience with its foray into investment banking, and is restructuring its Dresdner Bank subsidiary.
Rumours fly about the blockbuster deals that may soon be done. Lehman Brothers, a Wall Street bank that is desperately fighting to restore confidence in its prospects, is at the centre of many of them. Barclays, Deutsche Bank, HSBC and Royal Bank of Canada are among the names to have been bandied about as predators in recent weeks. UBS, which has been hit by massive write-downs on mortgage-backed securities, is also the subject of whispers—with Barclays, Deutsche and HSBC again to the fore. Bright-eyed bankers peddle ideas for other combinations. How about Lehman’s Wall Street clout and Standard Chartered’s emerging-markets network? Or HSBC and Merrill Lynch?

Short of an implosion to rival that of Bear Stearns in March, however, the rumours are unlikely to become real deals for the time being. For sellers, shares have fallen so steeply that deals are only for the truly desperate. Lehman, where the employees own lots of the equity, has a strong reason not to sell out while prices are so low. UBS is badly bloodied, but has raised lots of capital and said on July 4th that it will come close to breaking even in the second quarter. In Germany the long-awaited sale of Postbank, a retail bank, is reportedly sticking on the optimistic price expectations of Deutsche Post, its parent.

More importantly, buyers are scarce. “There are so few people with strong hands to play,” says Huw van Steenis, an analyst at Morgan Stanley. Those banks that do have the firepower to make purchases have plenty of reasons to sit tight.

In an environment this febrile, banks are anxious to husband their own capital rather than deplete it. Deutsche Bank is under pressure to bring down its leverage ratio, a measure of gross assets to capital. Barclays raised £4.5 billion ($9 billion) in June, but is still more thinly capitalised than many of its peers. HSBC has been burnt by its disastrous acquisition of Household, an American lender, and is in any case committed to expanding in emerging markets rather than developed ones.

Remember too that those banks able to contemplate acquisitions just now are the very ones that tended to manage their balance-sheets most conservatively in the run-up to the crisis. Taking a bet on a big deal today would be a huge and uncharacteristic gamble. Due diligence on banks’ structured-credit exposures remains a nightmarish prospect for would-be acquirers (“a toxic tool-chest of joy” is one observer’s pithy description of Lehman).

Liquidity is also now a big part of buyers’ calculations. Few want to bump up the amount of debt that needs to get rolled over while credit markets are still dislocated. Inevitably, accounting standards add to the complexity, by requiring acquirers to account for the assets and liabilities they buy at fair value.

In addition, paying out today makes little sense, because targets are still getting cheaper. On July 7th the KBW Bank index of American commercial-bank shares fell to its lowest level since 1997, as investors fretted about rising credit losses. Buyers
would doubtless also welcome greater certainty about the regulatory reforms before forking out, particularly over the higher capital requirements the investment banks may have to bear.

Regulators themselves may set up roadblocks to deals, either because they take a generally dim view of capital-sapping acquisitions or because of the rules. The restriction that no bank can own more than 10% of American deposits is one reason to doubt reports linking JPMorgan Chase and Wachovia. For UBS, the Swiss would also doubtless want a foreign buyer to decamp to Switzerland, a big barrier to a deal. “Consolidation will come in two years’ time, not now,” says Alessandro Profumo, the boss of UniCredit, an Italian bank. “For now, people are conserving capital.”

The less that big pieces of the jigsaw move, the more smaller ones will instead. Banks’ need for capital is not yet satisfied and there is mounting concern that investors are less willing to inject cash into sinking assets (see article). Disposals are the obvious escape route. Some smaller deals are already being done. Bidding is under way for the insurance arm of Royal Bank of Scotland; Banco Sabadell and Banco Pastor, two Spanish banks, have put bits of their insurance divisions on the block too. Citigroup is in talks to offload its German retail operations; predators will doubtless hope that it decides to sell some of its emerging-markets operations too. Deutsche snapped up the Dutch corporate-banking arm of ABN AMRO from Fortis, a Benelux bank, for a song on July 2nd. It paid £709m ($1.1 billion) in cash.

Expectations grow that Merrill Lynch, which is due to report its second-quarter earnings on July 17th, will sell some or all of its stakes in Bloomberg, an information provider, and (more damaging to future earnings) BlackRock, a thriving fund manager. A phoney war has broken out down under in anticipation that HBOS, Britain’s biggest mortgage lender, will offload its Australian unit. According to one of Europe’s most senior bankers, there will be “an unending fire-sale of non-core assets” over the next 18 months.

The big question, of course, is whether that will keep bank finances shored up long enough for markets to stabilise. If losses continue to spiral, capital dries up, and disposable assets cannot find purchasers, banks will have little choice but to cut back even harder on lending, or to take whatever price they can get.