Free State of Bavaria

Rating report

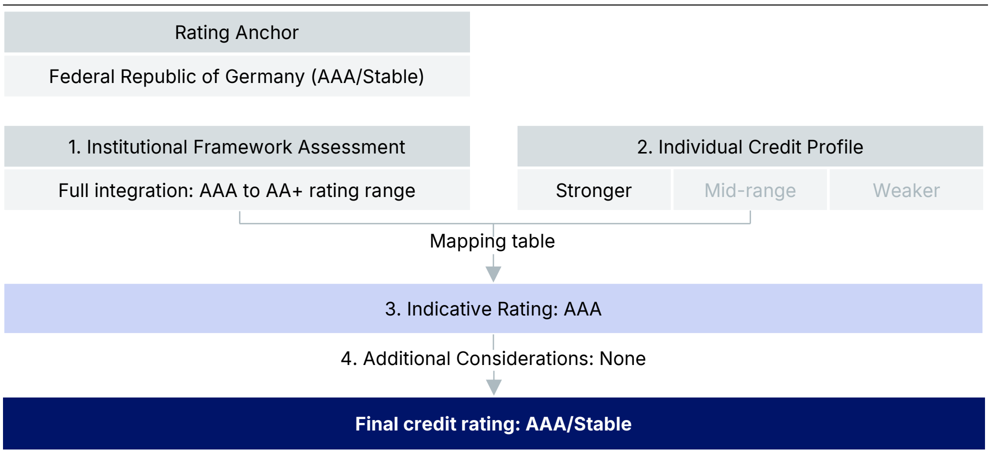
The Free State of Bavaria's (Bavaria) AAA rating is driven by:

A highly integrated Institutional Framework characterised by a strong revenue equalisation system, where Bavaria is a net contributor among the Länder, and the federal solidarity principle. This framework closely aligns the creditworthiness of the Länder with the German federal government's AAA/Stable ratings. Recent amendments to Germany's fiscal framework, including the easing of the debt brake, now allow the Länder collectively to run a structural deficit of up to 0.35% of national GDP and to access up to EUR 100bn in federally sourced infrastructure funding. While this provides additional fiscal capacity, it also reflects a shift toward a more expansionary fiscal stance. We expect operating balances across the Länder to remain under pressure, having declined from pre-pandemic levels due to higher personnel and administrative costs as well as slower economic momentum. These factors suggest a shift toward moderately higher deficits, though within a still-supportive institutional and fiscal framework.

A strong Individual Credit Profile, underpinned by i) excellent debt and liquidity management with excellent capital market access and a low debt burden, ii) sound budgetary management, strong budgetary performance and a continued commitment to the debt brake, iii) a large, wealthy and highly competitive economy, and iv) above-average revenue flexibility, further supported by its status as a net contributor to the national fiscal equalisation system.

Credit challenges relate to moderate budgetary flexibility given elevated spending on personnel and transfers, sizeable but manageable contingent liabilities and a high pension burden weighing on expenditure flexibility in the long-term.

Figure 1: Bavaria's rating drivers



Note: For further details, please see Scope's Sub-sovereigns Rating Methodology.
Source: Scope Ratings

Foreign currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

Local currency

Long-term issuer rating/Outlook

AAA/Stable

Senior unsecured debt

AAA/Stable

Short-term issuer rating/Outlook

S-1+/Stable

Lead Analyst

Eiko Sievert
+49 69 6677389-79
e.sievert@scoperatings.com

Team Leader

Alvise Lennkh-Yunus
+49 69 6677389-85
a.lennkh@scoperatings.com

Credit strengths and challenges

Credit strengths	Credit challenges
• Integrated institutional framework • Excellent debt and liquidity management with excellent capital market access and a low debt burden • Sound budgetary management and strong budgetary performance • Large, wealthy, and diversified economy • Above-average revenue flexibility, net payer in the financial equalisation system	• Moderate expenditure flexibility, near-term spending pressures • Sizeable but manageable contingent liabilities • High pension burden weighing on long-term expenditure flexibility

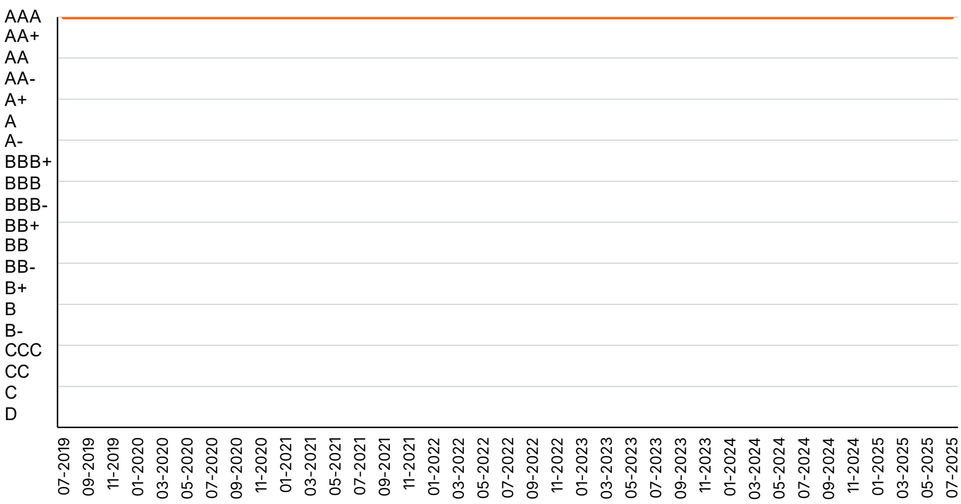
Table of content

Outlook and rating triggers

The Stable Outlook reflects Scope's view that risks to the ratings are balanced.

Positive rating-change drivers	Negative rating-change drivers
• N/A	• Downgrade of Germany's sovereign rating • Changes in the institutional framework, resulting in a notably weaker individual credit profile • Significant and structural deterioration of Individual credit profile

Figure 2: Rating history[1]



Source: Scope Ratings

[1] Foreign-currency long-term issuer rating. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment

1. Institutional framework

German Länder[2] benefit from a mature, highly predictable, and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the constitution; ii) strict fiscal rules and monitoring, iii) wide-ranging participation and veto-rights of the federal states in the national legislation; iv) equal entitlement of federal states regarding negotiations on federal reforms; and v) a solidarity principle that ensures extraordinary system support during budgetary emergencies.

Federal framework results in close rating alignment…

The federal system under which the Länder operate is the most integrated among the European sub-sovereign systems we cover. This is driven by our assessments of 'full integration' for extraordinary support and bailout practices, ordinary budgetary support and fiscal equalisation, fiscal rules and oversight, and revenue and spending powers. We assess funding practices as 'medium integration' (see Appendix I for an overview).

The framework assessment for the German Länder results in an **indicative downward rating adjustment of up to one notch** from Germany's AAA/Stable rating.

…with distance of up to one notch from the sovereign rating.

1.1 Extraordinary support and bail-out practices

Our framework assessment acknowledges a record of extraordinary financial support. Länder have been granted exceptional financial support from the federal government in five instances: Bremen (1992, 2006), Saarland (1992, 2005) and Berlin (2002). The court approved claims on the grounds of the solidarity principle, or *Bundestreueprinzip*, under which the Länder and the federal government are required to support each other in the event of a budgetary emergency. A claim by Berlin was denied in 2006, with the court arguing that the city-state was not in an extreme budgetary situation. However, the judges noted that federal emergency support would still be possible as a last resort if the budget and/or debt situation were later assessed as extreme. We consider the *Bundestreueprinzip* to be an implicit bail-out rule, as it requires the provision of federal support in times of budgetary stress.

Strong solidarity principle ensures extraordinary support

More recently, the federal government confirmed its role as a primary countercyclical shock absorber during the Covid-19 and energy crises in 2020-2023. Over these years, the federal government financed most countermeasures and offered direct grants to the Länder to mitigate the impact on their finances.

Federal government as shock absorber during recent crises

1.2 Ordinary budgetary support and fiscal equalisation

The federal financial equalisation system strongly aligns different fiscal capacities across the Länder. A reformed equalisation system took effect in 2020, with horizontal distribution occurring among the Länder via deductions and top-ups to collected VAT, as well as vertical transfers from the federal government.

Comprehensive fiscal equalisation system

As in the previous system, Bavaria is the largest net contributor with deductions on its VAT revenue of around EUR 9.8bn in 2024, accounting for 52% of total volumes. However, the system change has the advantage for all federal states that the federal government's contributions are higher in the reformed system.

Bavaria is the largest contributor to the equalisation system

1.3 Funding practices

Länder governments have broad autonomy in their funding choices. There is no use of sovereign on-lending, and Länder can decide autonomously on their borrowing programmes within the framework of the debt brake. Short-term liquidity is available via access to shared liquidity among the Länder and the federal government, essentially eliminating liquidity risk. Basel III risk-weights for Länder debt securities are aligned at 0% with the central government. The Länder have a history of joint bond issuance, having issued such instruments on 66 occasions, although not all of the 16 Länder participated. Bavaria has not participated in any of the past issues.

Autonomous borrowing, access to shared liquidity

[2] We use the term 'Land' (or collectively 'Länder') and 'state' interchangeably to refer to German federal states.

1.4 Fiscal rules and oversight

Since 2020, the Länder have to comply with debt brakes. Until recently, they could not run structural financing deficits unless, for example, hit by a severe economic downturn or a natural disaster.[3] Following the recent amendments to the debt brake framework, the Länder, in aggregate, will be entitled to run a structural deficit of 0.35% of national GDP[4] and to access EUR 100bn from the national infrastructure special fund. The government has agreed on the distribution of the additional headroom in line with the Königssteiner Schlüssel, however finalisation of the draft law is pending the remaining legislative process in the Bundestag and Bundesrat. While we expect most Länder to at least partially make use of the higher borrowing capacity, there will be differences among them in the implementation and extent of usage of the new borrowing flexibility.[5] While this will lead to higher levels of debt, the debt-to-operating revenue ratio should remain relatively stable.

Debt brake anchors borrowing; recent amendments will allow for limited structural borrowing for the Länder

The cyclical component of the debt brake and the exemptions in cases of a severe economic downturn or a natural disaster remain unchanged, for the Bund and the Länder. The German federal parliament used the emergency clause of the debt brake in 2020-2023 in response to the Covid-19 and energy crises. Similarly, in 2020-22, Bavaria invoked the safeguard clause of its debt brake to implement support measures and credit authorisations to mitigate the impact of the pandemic.

Compliance with the debt brake and Länder finances are monitored by the Stability Council. The Council monitors restructuring programmes and compliance with budgetary targets and comprises the Länder's finance ministers and the federal ministers of finance and economic affairs. If the Council determines that a Land is threatened with a budgetary emergency, it agrees on a restructuring programme with the affected authority.

Stability council conducts oversight

In late 2023, Germany's constitutional court ruled the Second Supplementary Budget Act 2021 of the federal government as unconstitutional. Crucially, the ruling effectively limits the previously commonly used budgetary practice of using emergency credit authorisations to create budgetary reserves for spending in future years, thus also impacting budgetary practices of the Länder.

15 November 2023 constitutional court ruling had implications for the Länder…

The Bavarian Budget Act 2022 allowed for EUR 5.8bn in credit authorisations to cover pandemic-related costs and to fund the Hightech Agenda Plus, stating that credit authorisations can be transferred if the credit funds have not been taken out by the end of the 2022 financial year and are still required. While a court ruling was filed against the 2022 Budget, the credit authorisations were not needed, and spending needs were covered from the general budget.

…but no material repercussions for Bavaria.

1.5 Revenue and spending powers

The Länder and the federal government share a taxation authority and jointly decide on rates and revenue distribution for high-revenue common taxes (income and VAT). The latest reform of federal financial relations (in 2017) took effect in 2020 and resulted in a higher share of VAT revenue being distributed among the Länder. The VAT distribution fully compensates for the variation in taxing powers, replacing the previous process of horizontal payments between the Länder. Alongside common taxes, the central government and the Länder have separate taxation authorities for lower revenue-generating taxes.

Shared tax authority with the federal government

Under the reform agreed in 2017, the Länder have assigned limited executive and legislative rights to the central government in certain policy areas, including physical and digital infrastructure and the higher education system, in return for higher payments from the equalisation system. In line

Federal reforms strengthen political coherence

[3] The debt brake is a legal framework that prohibited structural deficits for the Länder from 2020 onwards; article 109 (3) of the Basic Law stipulates that the Länder may incur deficits in a case of, for example, a recession or a natural disaster provided they pass respective legislation at the state level.

[4] The federal debt brake, similarly, caps the structural annual deficit of the central government at 0.35% of GDP.

[5] The changes to the national constitution regarding the debt brake effectively overwrote state laws as most states have manifested the debt brake regulations in either constitutional or ordinary law. This step ensures the same opportunities across the Länder, but was criticised by some for going against Germany's federalism. Additionally, EUR 100bn of the national government's EUR 500bn infrastructure fund will be attributed to the regional authorities. Additional national law will have to define the allocation of funds between Länder.

with earlier reforms (*Föderalismusreformen II*), we observe that the higher the share of common national legislation (*konkurrierende Gesetzgebung*), the more integrated the system becomes.

1.6 Political coherence and multi-level governance

The German federal system is very predictable and supportive. Major reforms are discussed and agreed upon well in advance and in consultation with the Länder, which can directly influence national policymaking via the upper house of parliament.

Special role of Bavaria with regional party

Bavaria has a unique role in the political landscape. It is the only federal state with a separate party: the Christian Social Union (CSU). The CSU has been in power since 1957 under different coalitions but usually as a one-party government, and it has always appointed the state's prime minister. The party also has a long-standing agreement with the Christian Democrats to cooperate in federal and regional elections.

2. Individual credit profile (ICP)

Strongest individual credit profile among peers

We assess Bavaria's ICP as 'stronger' among German Länder. This places the Land's indicative rating at AAA, given our assessment of very close integration with the federal government and our mapping table. For details, see Appendix II and Appendix III.

Bavaria's individual credit strengths include: i) excellent debt and liquidity management with excellent capital market access and a low debt burden, ii) sound budgetary management and strong budgetary performance, iii) a large, wealthy and highly competitive economy, and iv) above-average revenue flexibility, bolstered by its status as a net contributor to the national fiscal equalisation system.

Key challenges relate to moderate budgetary flexibility given elevated spending on personnel and transfers, sizeable but manageable contingent liabilities and a high pension burden weighing on expenditure flexibility in the long-term.

3. Debt and liquidity

3.1 Debt burden and trajectory

Low debt burden

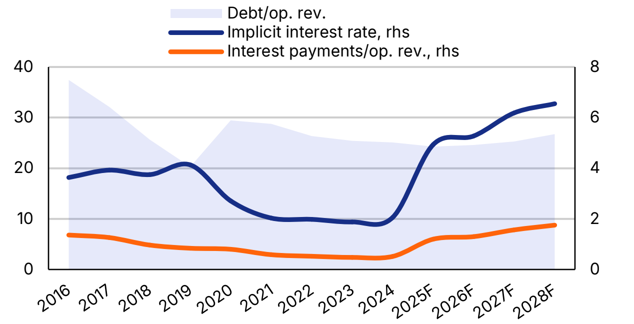
Bavaria's credit profile benefits from a low debt burden in a national and international context. Before Covid-19, direct debt excluding guarantees had declined significantly from 56% of operating revenue in 2013 to 20% at end-2019 (**Figure 3**). By end-2021, due to pandemic-related borrowing, debt had increased to 29% of operating revenue (EUR 19.9bn). The ratio recovered in subsequent years, declining to 25% at end-2023, but remained stable in 2024 as the debt stock increased slightly while operating revenues also increased.

We expect a further moderate increase in debt over the coming years. Nevertheless, the debt-to-operating revenue ratio should remain relatively stable due to the simultaneous recovery of tax revenues. A substantial economic boost following the loosening of fiscal rules in Germany could set the debt-to-operating revenue ratio for Bavaria on a declining path. In line with previous years, Bavaria used cash to service its debt in 2023 and increased its postponed credit authorisations by EUR 1,240m to EUR 19.2bn.

Significant deferred credit authorisations

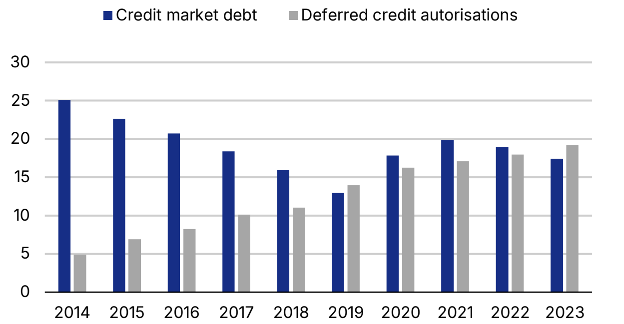
Unlike most other Länder, Bavaria has built up substantial deferred credit authorisations in past years, forming part of its active liquidity management and risk optimisation strategy (**Figure 4**). In Bavaria, debt is only issued when funding is actually needed, which accounts for the relatively large volume of deferred debt being carried forward compared to other Länder.

Figure 3: Debt and interest burden, %



Sources: Bayerisches Staatsministerium der Finanzen und für Heimat, Destatis, Scope Ratings

Figure 4: Credit market debt and deferred credit authorisations, EUR bn



Sources: Bayerisches Staatsministerium der Finanzen und für Heimat, Scope Ratings

Significant increase but still low debt following pandemic

In response to the Covid-19 crisis, Bavaria passed legislation to invoke the safeguard clause of its debt brake and adopted budgetary measures and credit authorisations. Pandemic-related funds have been collected under a dedicated account (chapter 13 19 *Sonderfonds Corona-Pandemie*) in the Land's core budget created in 2020 to address the Covid-19 crisis. Actual debt take-up amounted to EUR 10.2bn over 2020-2022 and was hence significantly lower than the authorised volumes of EUR 37.4bn. In the 2023 budget, no new credit authorisations were included and the Land permanently redeemed EUR 300m, EUR 250m more than the budgeted volume of EUR 50m.

Debt service to rise modestly due to Covid debt repayment

Credit authorisations under the debt brake emergency clause come with a pre-defined redemption plan. Bavaria planned to amortise debt taken on under chapter 13 19 in annual instalments of 5% of the total amount incurred under the 2020 credit authorisation from 2024, and from 2025 for debt incurred under the 2021 credit authorisation. The Budget Act 2024/2025 limits planned repayments to EUR 50m in 2024 and the same amount in 2025 given the challenging short-term economic outlook. Any pandemic-related debt still outstanding at the end of 2025 will be repaid in equal instalments with the debt fully paid off by 2044. As actual take-up of debt was substantially lower than budgeted, mandatory redemptions should stay well below EUR 1bn per year.

Discussions to take on new debt in 2026

Bavaria has traditionally been an advocate of the debt brake and demonstrated continuous commitment to no new net borrowing. In light of the challenging economic outlook and the need to boost investments, Bavarian State Premier Markus Söder has signalled that new debt issuance may be appropriate in 2026. This will depend on new tax revenue estimates expected in autumn and would be in line with the revised debt brake framework agreed in March 2025 by the German Parliament. While the Land's nominal debt would increase, Bavaria would remain in a favourable position given its very low debt-to-operating balance compared with peers.

3.2 Debt profile and affordability

Bavaria benefits from a very low interest burden compared to peers, low-interest rate risk and prudent debt management. Additionally, refinancing risk is remote as for all Länder. Based on recent Stability Council assessments, Bavaria will continue to outperform most German Länder in terms of fiscal indicators.

Prudent debt management

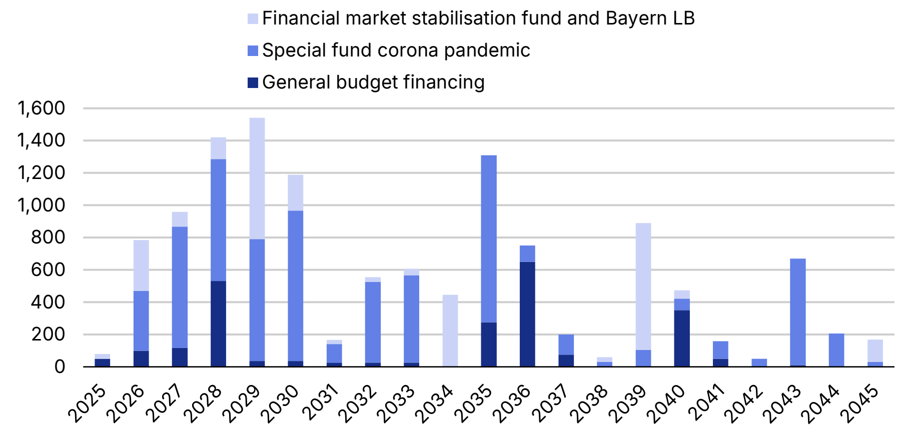
Prudent debt management ensures a high degree of predictability with a debt portfolio consisting of only fixed-rate debt. The maturity profile is balanced (**Figure 5**) with less than 5% of total debt maturing in the next 2 years as of end-June 2025.

Low interest payment burden

Continued debt reductions in recent years contributed to a fall in Bavaria's interest payments relative to operating revenue to 0.5% in 2022 from 2.0% in 2013, bolstering its fiscal position. Despite the sharp rise in interest rates since 2022, the interest payments-to-operating revenue ratio remained stable in 2023 and 2024 (**Figure 3**). We expect interest payments to also stay below 2% of operating revenue over the coming years.

Bavaria's implicit interest rate of 2.1% in 2024 is one of the highest among the Länder. However, due to low funding needs, Bavaria did not access bond markets between 2014 and 2020. Since low interest rates were therefore not locked-in to the same extent as in other Länder, the interest burden relative to peers is expected to decline. The comparably high implicit interest rate also results from the deferral of credit authorisations as part of the active debt and liquidity management. The ratio of interest expenses to credit market debt plus deferred credit authorisations stands at only 1.07% in 2024.

Figure 5: Debt redemption profile, EUR m



Source: Bayerisches Staatsministerium der Finanzen und für Heimat, Scope Ratings

3.3 Contingent liabilities

Contractual guarantees exhibit low risks

Contractual guarantees issued by Bavaria stood at EUR 15.3bn in 2023, up from about EUR 11.2bn in 2022, and remain overall moderate. Guarantees were issued mostly for social housing (EUR 2.6bn), as well as for individual authorisations (EUR 12.3bn) covering various areas, such as a local transport project in Munich. High property values make it less likely that Bavaria will need to honour guarantees relating to real estate transactions. In addition, guarantees for debt incurred by social housing associations are not material to the budget, because of the associations' stable rental income.

Contingent liabilities related to BayernLB

Bavaria's shareholding of BayernLB (total assets of EUR 286.7bn as of March 2025) increased from 75% to 80% following the conversion of its silent participation into regular equity capital in December 2024. The holding in BayernLB gives rise to some contingent liability risk, however much reduced after BayernLB repaid its state aid in full in 2017.[6] The repayment of Bavaria's capital contribution led to an early conclusion of related EU proceedings. The bank's balance sheet is strong with i) a solid capital base, reflected by a CET1 capital ratio of 21.1% in March 2025, well above the regulatory requirement (9.5% minimum for 2025); and ii) a low NPL ratio of 1.1%.

Solid management of major holdings

Bavaria's strong management of its major shareholdings is reflected in its robust financial performance, indicating a low risk of related contingent liabilities materialising. The Covid-19 crisis hindered the profitability of several holdings in 2020 and 2021, with Bavaria providing support via loans or capital injections. These holdings have recovered strongly since then, particularly the Messe München GmbH which has seen record revenues due to a large increase in demand for trade fairs and conference events.

Pension payments weight on long-term budgetary flexibility…

[6] In 2008/2009, Bavaria injected EUR 10bn of capital into the bank and issued EUR 4.8bn in guarantees for Bayern LB's structured finance portfolio. Under the EU state-aid proceedings, the European Commission scheduled a repayment of EUR 4.96bn until 31 December 2019 at the latest. With the repayment of EUR 1bn as of 30 June 2017, BayernLB has fully met the repayment obligation. The guarantees for the structured credit portfolio were terminated in 2014.

Finally, pension expenditure will take up a growing share of Bavaria's budget. The number of eligible pensioners is set to rise to 185,000 in 2040 (up 16% from 2024), weighing on the state's long-term expenditure flexibility.

... but provisions and annual contributions serve as buffers

To ease the rising pressure from pension obligations, Bavaria has: i) implemented cost-saving measures; ii) pursued prudent fiscal policy and iii) created a pension fund. The capital stock of the pension fund stood at EUR 4.0bn at end-2023. Total contributions to the fund amounted to EUR 137m in 2023, including collected pension allowances and statutory annual fund inflows of EUR 110m planned to continue until 2030. Overall, the combined measures, including anticipated savings, will result in a moderate share of pension expenditure with a peak of 10%-12%, broadly in line with levels in 2018. Pay-outs from the fund are possible since 2023, but none have been made so far.

3.4 Liquidity position and funding flexibility

Bavaria's liquidity management is prudent and supported by appropriate inter-year cash planning, diverse liquidity sources, and ample reserves. Cash holdings are sizeable with liquid reserves as a share of debt service being one of the highest among national peers.

High own cash reserves, solid cash flow profile and conservative liquidity planning

Bavaria benefits from highly predictable cash flow and prudent budgetary assumptions for liquidity planning. The state's cash flows, especially inflows, are prone to seasonal variations driven by the tax calendar. Like other Länder (excluding city-states), Bavaria's cash reserves tend to increase over the year, with peaks in mid-April, June, July and October followed by significant outflows at the end of October and in November. These seasonal variations explain the state's excess liquidity during the year.

Diverse liquidity sources

Credit facilities from major financial institutions provide additional access to liquidity to bridge intraday financing needs if required. Finally, a further source of liquidity is available in the form of commercial cash transactions between the German Länder, which lend excess liquidity to each other. Combined with Bavaria's own sizeable reserves, this makes the risk of a liquidity shortfall negligible.

Excellent capital market access and low financing needs

Bavaria's funding access in capital markets is excellent as observed during the Covid-19 crisis. The state re-entered the bond markets in 2020 and 2021 for the first time since end-2014, issuing mostly at near-zero coupons. Total net credit market borrowing amounted to EUR 7.2bn and EUR 3.4bn respectively in 2020 and 2021, including bond issuances, private placements and promissory notes. In 2022 and 2023 the state did not access public debt markets, reflecting low financing needs. After a benchmark emission of EUR 500m at end-2024, Bavaria accessed bond markets again in early 2025 for a volume of EUR 1bn.

Bavaria employs a conservative debt-management strategy with no foreign currency exposure and low interest rate risk. The debt service profile is balanced with around one-third of debt maturing in the next five years (**Figure 5**).

4. Budget

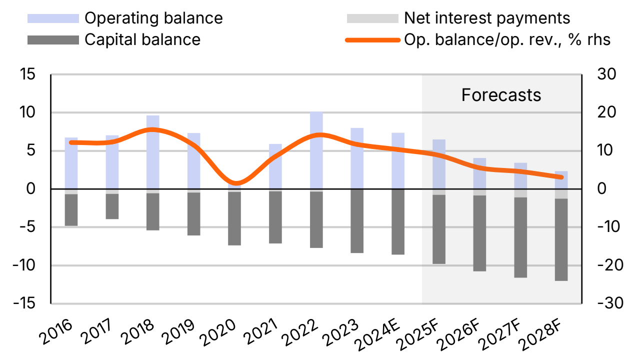
4.1 Budgetary performance and outlook

Bavaria benefits from i) conservative budget management; ii) a track record of commitment to fiscal consolidation; iii) the ability to adjust budgets in view of the high investment levels; and iv) economic and demographic outperformance of national peers.

Strong budgetary performance and flexibility

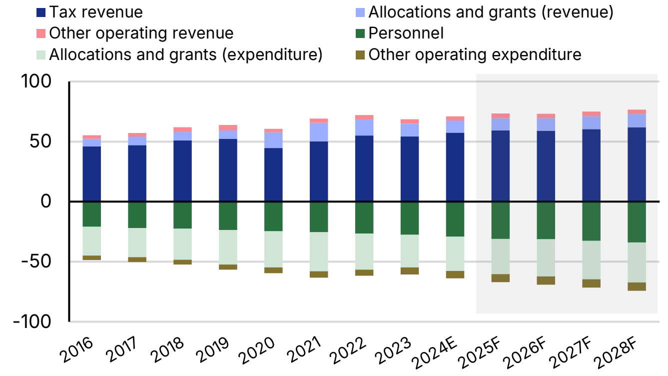
Bavaria displays a strong budgetary performance, with historically high operating surpluses averaging 12.9% of operating revenue in 2015-2019 (**Figure 6**). Bavaria's strong historical performance has been underpinned by rising tax revenue, continuous cost control and conservative budgetary management, which have supported a substantial reduction in debt and a build-up of cash reserves.

Figure 6: Budgetary performance, EUR bn (lhs); % (rhs)



Sources: Bayerisches Staatsministerium der Finanzen und für Heimat, Scope Ratings

Figure 7: Components of operating balance, EUR bn



Sources: Bayerisches Staatsministerium der Finanzen und für Heimat, Scope Ratings

Bavaria's budget impacted by the Covid-19 crisis

After years of budgetary surpluses and net debt reduction, budgetary results in 2020 and 2021 were driven by the Covid-19 pandemic. Due to greater uncertainty and efforts to increase operational flexibility, Bavaria passed one-year budgets for 2021, 2022 and 2023, instead of the usual two years as reintroduced for 2024/2025. Bavaria's financial results worsened from a surplus of around EUR 1.2bn in 2019, or 2% of total revenue, to deficits of 10.3% in 2020 and 1.7% in 2021.

A strong fiscal recovery in 2022

In 2022, the state posted strong results, ending the year with a EUR 2.4bn surplus before debt movements, or 3.3% of total revenue. Financial performance benefitted from strong nominal tax revenue, up 10% from 2021 and gradually declining allocations and grant payments. Positive results allowed for debt repayments of EUR 100m related to the special fund for the financial market and BayernLB.[7] Additionally, at the end of 2022, all unused credit authorisations in the special coronavirus pandemic fund (chapter 13 19) were retired, meaning that no more emergency credit authorisations were available from the 2023 financial year.

2023 budget balanced; increasing spending pressure

Despite increasing operating pressures, Bavaria did not require any new net borrowing in 2023 and redeemed EUR 300m. Operating revenues declined by 4.6% due to lower taxes and a reduction in allocations and grants received after the pandemic years. While allocations and grants paid also declined, operating expenditure decreased by only 1.9% in comparison given inflationary pressures and increased personnel costs.

Return to two-year budget plans from 2024/25

With the 2024/25 Budget, Bavaria returned to two-year budget plans. Operating pressures persist and expenditure growth continued to outpace revenue growth in 2024. The special fund 'BayernFonds' was closed at end-July 2024 and its debt of EUR 40.4m fully redeemed with budgetary resources.

No new net borrowing in 2024/25 and continued high investments

Operating pressures continue in 2025 as economic growth remains weak, which is expected to lead to subdued tax revenues. Planned total expenditure was increased under the Supplementary Budget Act 2025, partially driven by higher spending to support municipalities, while the allocation of EUR 460.5m to the economic stimulus reserve originally anticipated in the budget was suspended. Nevertheless, the 2025 budget continues to be balanced without any new net borrowing, and investments remain high with capital expenditure as a share of total expenditure rising to around 14%.

Operating expenditures continue to outpace operating revenues

Like other German Länder, Bavaria will continue to face budgetary pressures in 2025 and beyond. Operating expenditure growth is forecast to average 3.9% over 2025-2028, while operating revenue growth is expected to average 1.9%. In response to these budget pressures, the Supplementary Budget Act 2025 already stipulates a general moratorium on public sector jobs for 2026 and the start of a gradual reduction of 5,000 positions by 2030. Given Bavaria's strong

[7] All redemptions quoted are in budgetary terms. Given Bavaria's use of deferred credit authorisations, actual redemption on the credit market can be higher. In this case, total credit market redemption amounted to EUR 591m of which EUR 491m in unused credit authorisations were deferred.

budget discipline and track record, we therefore anticipate additional consolidation measures in the 2026/27 budget.

4.2 Revenue flexibility

Länder have overall moderate revenue flexibility…

As for all German Länder, Bavaria's revenue flexibility is generally limited as a large share of operating revenue stems from shared taxes. In line with constitutional arrangements, the Länder receive shared taxes, largely revenues from personal income taxes, VAT and corporate taxes. These revenues are initially collected by regional tax offices but are later redistributed at a national level in accordance with revenue-sharing agreements and additional transfer mechanisms.

…but Bavaria enjoys above-average flexibility.

However, vis-à-vis peers, Bavaria enjoys above-average flexibility as a net payer to the financial equalisation system. The share of transfers to operating revenue is one of the lowest among the Länder.

4.3 Expenditure flexibility

Moderate expenditure flexibility

Relative to other Länder, Bavaria's expenditure flexibility is supported by a relatively high share of total expenditure on investments (14% on average over 2022-2024) and limited administrative costs (around 8% in 2023). Bavaria further has a record of fiscal consolidation and implementing cost cuts during economic downturns to offset budgetary shocks, which is reflected by a decline of 2.3% in operating expenditure in 2022 and a further decline of 1.9% in 2023. At the same time, Bavaria's operating expenditure structure is rigid, with large items relating to transfers and grants (45% of total expenditure) and elevated personnel costs (45%).

5. Economy

5.1 Wealth levels and economic resilience

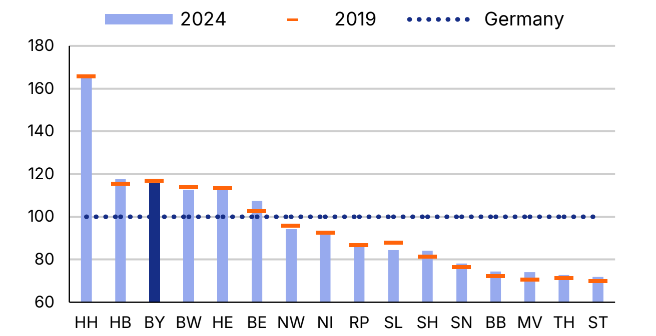
Key economic region in Germany

Bavaria has a favourable socio-economic profile underpinned by a large, wealthy, well-diversified and highly competitive economy, resulting in a high regional growth potential and a strong ability to generate its own long-term revenue. Bavaria is a key economic region in Germany, contributing 18% of national GDP in 2024. The state is also one of the wealthiest regions in Europe, with a GDP per capita at 116% of the German average (**Figure 8**).

Highly competitive economy, robust recovery from Covid-19 but contraction in 2024

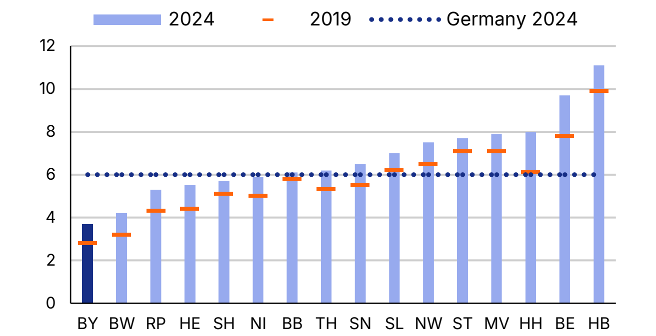
In the five years before the Covid-19 crisis, economic expansion was strong with average real GDP growth of 2% over 2015-2019, outperforming the German average of 1.8%. Due to the Covid-19 shock, Bavaria's real GDP declined by 4.1% in 2020, in line with the German average. The economic recovery in 2021 and 2022 was robust and above the national average with 4.2% and 1.9% real GDP growth respectively. This was despite the impact of global supply chain disruptions, as well as high energy prices and other economic effects of the Russian invasion of Ukraine. Bavaria's economy also slightly outperformed the German economy over 2023 and 2024, with economic output first increasing and then declining by 1%, while the German economy contracted by 0.3% and 0.2% in the two years.

Figure 8: GDP per capita, % of national average



Sources: Statistische Ämter des Bundes und der Länder, Scope Ratings

Figure 9: Unemployment rate, %



Sources: Destatis, Scope Ratings

5.2 Economic sustainability

Lowest unemployment in Germany

Bavaria enjoys favourable labour market characteristics, even though the Covid-19 shock caused the unemployment rate to increase to a high of 4.2% in February 2021, from 2.8% in December 2019. In May 2025, the unemployment rate stood at 3.9%, 1.1pp above its 2019 level. Robust labour market outcomes over the course of the pandemic and energy shock reflect the federal government's large discretionary support, e.g. in the form of a national furlough scheme, or *Kurzarbeit*. While the unemployment rate remains above pre-pandemic levels and has gradually increased since 2022 amid a subdued economy, Bavaria continues to have the lowest unemployment rate among all German Länder (**Figure 9)**.

Relatively favourable demographic profile

Bavaria benefits from positive demographics compared to other Länder, supporting Bavaria's long-term growth and tax revenue potential. Bavaria's statistical office projects a 4.3% increase in total population from 2023 to 2043. At the same time, ageing will lead to an increase in the proportion of people aged 65 and over versus those aged 20-64, from 35% in 2023 to around 44% in 2043.

6. Governance

6.1 Governance and financial management

Stable political environment

We assess Bavaria's quality of governance and financial management as strong. This is supported by the state's: i) record of nominal debt reduction; ii) regular fulfilment of policy objectives defined in strategic plans; and iii) ability to weather economic downturns by cutting costs to compensate for adverse budgetary developments.

Governing coalition of CSU/Free Voters

After losing its electoral majority in 2018, the CSU reached a coalition agreement with the smaller, conservative Free Voters party. The coalition remained in power following the October 2023 elections with the CSU winning 37% of the vote and the Free Voters 15.8%. CSU's Markus Söder is the state's Prime Minister, while the Free Voters run four ministries: economy, environment, culture and digital.

Continued commitment to the debt brake but increased investments

The national governments fiscal stimulus package and move to loosen the debt brake in March 2025, also impact Länder's budgetary practices. While the fiscal objective of continuously reducing Bavaria's debt is legally enshrined in the Bavarian budgetary laws (Bayerische Haushaltsordnung), national law takes precedence over the law of the Länder. Bavaria will therefore also be able to take on limited amounts of structural debt. The state's Prime Minister already indicated that new debt may be needed to address investment backlogs in 2026. Nevertheless, we expect new borrowing to be contained and the coalition to generally stick to agreed priorities for the 2023-2028 administrative term including: i) compliance with the debt brake mechanism; ii) a gradual reduction of debt levels and repayment of pandemic-related debt starting from 2024; iii) a continued build-up of reserves; and iv) increased investments.

7. Environmental and social considerations

7.1 Environmental factors and resilience

Ambitious climate targets

In 2021, Bavaria introduced the Bavarian Climate Protection Act (BayKlimaG), making legally binding a reduction in greenhouse gas emissions of 65% per inhabitant by 2030 and climate neutrality by 2040 at the latest. Given rising economic challenges, the government intends to amend the Act to prolong the timeline until 2045, aligning with the national goals.

Elevated exposure to floodings

While physical risks from climate change are relatively low in aggregate, Bavaria was impacted by the substantial flooding in July 2021, though to a much lesser extent than North Rhine-Westphalia or Rhineland-Palatinate. With the establishment of a national Reconstruction Assistance fund (Aufbauhilfe 2021), the federal government made available up to EUR 30bn to support reconstruction in the affected areas; Bavaria received 1% of the fund.

According to a recent analysis conducted by environmental NGO *Deutsche Umwelthilfe*, in a Bundesländer comparison, exposure to floods is highest in Bavaria where 65,517 residential addresses are located in potentially flood-prone areas. Latest floods in June 2024 reflect this exposure.

7.2 Social factors and resilience

Relatively favourable demographics and educational attainment vs national average, but high cost of living

In terms of health and demographic indicators, Bavaria outperforms peers with an old-age dependency ratio of 33.6% compared with a national average of 35.9%. The state's life expectancy is the second highest in Germany after Baden-Württemberg. Bavaria outperforms national peers in educational rankings like PISA. Recognising that all German Länder however compare relatively weak internationally, Bayern launched the PISA Initiative in 2024 to strengthen German and Math in elementary schools.

However, like many regions, Bavaria faces high housing costs in urban centres and an elevated cost of living compared with other states. This poses challenges to housing affordability, particularly for lower-income residents, compounding socio-economic disparities.

7.3 Additional considerations

No adjustment was applied to the rating from additional considerations.

Appendix 1. Institutional Framework Assessment

To assess the institutional framework, we apply a Qualitative Scorecard (QS1) centred around 6 components. We assess each analytical component on a five-point scale ranging from a score of 0 for 'low' integration to 100 for 'full' integration. The institutional framework score, ranging from 0 to 100, is calculated as a simple average of these assessments. The score is then used to determine a rating range from the rating anchor level, within which the sub-sovereign's rating can be positioned.

Our assessment of intergovernmental integration between the Länder and the Federal Republic of Germany (AAA/Stable) results in an indicative **downward rating range of up to one notch** from the German sovereign, within which the Länder can be positioned according to their individual credit strengths.

Institutional Framework scorecard (QS1)

Analytical component	Full integration (100)	Strong integration (75)	Medium integration (50)	Some integration (25)	Low integration (0)
Extraordinary support and bail-out practices	●				
Ordinary budgetary support and fiscal equalisation	●				
Funding practices		●			
Fiscal rules and oversight	●				
Revenue and spending powers	●				
Political coherence and multilevel governance	●				

Integration score	**92**
Downward rating range	**0-1**

Institutional framework score	100 > x ≥ 90	90 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 > x ≥ 10	10 > x ≥ 0
Indicative rating range	0-1	0-2	0-3	0-4	0-5	0-6	0-7	0-8	0-9	0-10

Appendix 2. Individual Credit Profile

Risk pillar	Analytical component	Assessment		
Debt and liquidity	**Debt burden & trajectory**	Stronger	Mid-range	Weaker
	Debt profile & affordability	Stronger	Mid-range	Weaker
	Contingent liabilities	Stronger	Mid-range	Weaker
	Liquidity position & funding flexibility	Stronger	Mid-range	Weaker
Budget	**Budgetary performance & outlook**	Stronger	Mid-range	Weaker
	Revenue flexibility	Stronger	Mid-range	Weaker
	Expenditure flexibility	Stronger	Mid-range	Weaker
Economy	**Wealth levels and economic resilience**	Stronger	Mid-range	Weaker
	Economic sustainability	Stronger	Mid-range	Weaker
Governance	**Governance and financial management**	Stronger	Mid-range	Weaker

Additional environmental and social factors	Assessment		
Environmental factors and resilience	Positive impact	No impact	Negative impact
Social factors and resilience	Positive impact	No impact	Negative impact

ICP score	**90**
Indicative notching	**0**

Appendix 3. Mapping table

We derive the indicative sub-sovereign rating by mapping the result of the institutional framework assessment (i.e. the indicative rating range) to the ICP score.

For Bavaria, this results in an indicative rating aligned with the sovereign rating of AAA. No additional considerations apply.

Institutional framework assessment		Individual credit profile score							
Score	**Downward rating range**	100 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 ≥ x > 0
100 > x ≥ 90	0-1	0	0	0	0	0	0	-1	-1
90 > x ≥ 80	0-2	0	0	-1	-1	-1	-1	-2	-2
80 > x ≥ 70	0-3	0	-1	-1	-1	-2	-2	-3	-3
70 > x ≥ 60	0-4	0	-1	-1	-2	-2	-3	-3	-4
60 > x ≥ 50	0-5	0	-1	-1	-2	-2	-3	-4	-5
50 > x ≥ 40	0-6	0	-1	-1/-2	-2/-3	-2/-3	-3/-4	-4/-5	-6
40 > x ≥ 30	0-7	0	-1/-2	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7
30 > x ≥ 20	0-8	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-6/-7	-8
20 > x ≥ 10	0-9	0	-1/-2	-2/-3	-3/-4	-4/-5	-5/-6	-7/-8	-9
10 > x ≥ 0	0-10	0	-1/-2	-2/-3	-3/-4	-5/-6	-7/-8	-9/-10	-10

Note: Mapping table under section 4 of Scope's Sub-sovereigns Rating Methodology, as applied to the rating anchor's AAA-ratings.

Appendix IV. Statistical table

	2020	2021	2022	2023	2024	2025F	2026F	2027F	2028F
Budgetary performance (EUR m)									
Operating revenue	60,529	69,175	71,962	68,628	71,119	73,476	73,104	74,888	76,639
Operating revenue growth, %	*-5.2%*	*14.3%*	*4.0%*	*-4.6%*	*3.6%*	*3.3%*	*-0.5%*	*2.4%*	*2.3%*
Tax revenue	44,529	50,138	55,012	54,250	57,404	59,243	58,923	60,403	62,060
Allocations and grants	13,035	15,509	13,309	10,486	10,059	10,230	10,466	10,696	10,707
Other operating revenue	2,964	3,528	3,642	3,891	3,656	4,003	3,715	3,789	3,872
Operating expenditure	59,608	63,275	61,820	60,616	63,777	66,989	69,052	71,462	74,281
Operating expenditure growth, %	*5.5%*	*6.2%*	*-2.3%*	*-1.9%*	*5.2%*	*5.0%*	*3.1%*	*3.5%*	*3.9%*
Personnel	24,742	25,526	26,512	27,549	29,230	30,954	31,295	32,547	33,914
Allocations and grants	30,153	32,548	30,031	27,189	28,412	29,464	31,055	32,080	33,395
Other operating expenditure	4,714	5,201	5,277	5,879	6,135	6,571	6,702	6,836	6,973
Operating balance	920	5,900	10,142	8,011	7,342	6,488	4,052	3,426	2,358
Interest received	105	109	62	259	403	112	95	88	88
Interest paid	483	404	376	327	367	880	949	1,172	1,342
Net interest paid	378	295	314	69	-36	768	854	1,084	1,254
Current balance	542	5,606	9,828	7,943	7,378	5,720	3,198	2,342	1,104
Capital balance	-6,975	-6,834	-7,381	-8,305	-8,579	-9,041	-9,884	-10,497	-10,773
Balance before debt movement	-6,433	-1,229	2,447	-363	-1,201	-3,321	-6,685	-8,155	-9,669
New borrowing (credit market)	7,208	3,428	339	2,341	2,436				
Debt redemption (credit market)	2,326	1,365	1,257	3,881	2,039				
Net borrowing (credit market)	4,882	2,063	-919	-1,540	398				
Change in deferred credit authorizations	2,276	825	882	1,240					
Net borrowing (budget)	7,158	2,888	-36	-300					
Debt (EUR m)									
Direct debt (credit market)	17,829	19,892	18,973	17,433	17,830	17,830	17,989	18,943	20,488
Guarantees	9,765	10,787	11,153	15,286					
Overall debt risk (direct debt plus guarantees)	27,594	30,679	30,126	32,719					
Financial ratios									
Debt/operating revenue, %	29.5%	28.8%	26.4%	25.4%	25.1%	24.3%	24.6%	25.3%	26.7%
Debt/operating balance, years	19.4	3.4	1.9	2.2	2.4	2.7	4.4	5.5	8.7
Interest payments/operating revenue, %	0.8%	0.6%	0.5%	0.5%	0.5%	1.2%	1.3%	1.6%	1.8%
Implicit interest rate, %	2.7%	2.0%	2.0%	1.9%	2.1%	4.9%	5.3%	6.2%	6.5%
Operating balance/operating revenue, %	1.5%	8.5%	14.1%	11.7%	10.3%	8.8%	5.5%	4.6%	3.1%
Balance before debt movement/total revenue, %	-10.3%	-1.7%	3.3%	-0.5%	-1.6%	-4.3%	-8.9%	-10.5%	-12.1%
Transfers and grants/op. revenue, %	21.5%	22.4%	18.5%	15.3%	14.1%	13.9%	14.3%	14.3%	14.0%
Capital expenditure/total expenditure, %	12.4%	11.5%	13.0%	14.1%	13.7%	13.9%	15.4%	15.7%	15.6%
Economy and demographics									
Nominal GDP, EUR m	634,843	675,004	723,639	773,647	791,603				
GDP per capita, EUR	48,342	51,298	54,519	57,725	58,817				
GDP per capita, % of national GDP per capita	116.5%	116.1%	115.5%	116.6%	115.7%				
Real GDP growth, %	-4.1%	4.2%	1.9%	1.0%	-1.0%				
Population, '000s	13,140	13,177	13,105	13,176	13,249				
Unemployment rate, % labour force	3.6%	3.5%	3.1%	3.4%	3.7%				

Source: Land of Bavaria, Destatis, Statistische Ämter des Bundes und der Länder, Scope Ratings

Lead Analyst
Eiko Sievert
+49 69 6677389-79
e.sievert@scoperatings.com

Associate Analyst
Elena Klare
+49 69 6677389-21
e.klare@scoperatings.com

Team Leader
Alvise Lennkh-Yunus
+49 69 6677389-85
a.lennkh@scoperatings.com

Related research

Germany: Successful implementation of infrastructure investment key to growth, fiscal sustainability, 17 July 2025
Scope has completed a monitoring review for the Land of Hesse, 18 April 2025
Scope affirms the Land of Baden-Württemberg's AAA rating with Stable Outlook, 11 April 2025
Scope affirms NRW's AAA rating with Stable Outlook, 11 April 2025
Scope has completed a monitoring review for the Land of Berlin, 11 April 2025
Scope has completed a monitoring review for the Republic of Germany, 21 March 2025
Germany's borrowing to rise by EUR 625bn for infrastructure and defence, 6 March 2025
Germany's election: reform momentum strengthens even if debt-brake reform remains challenging, 24 February 2025
Sub-Sovereign Outlook: finances remain stable amid fiscal challenges, wider regional disparities, 13 February 2025
Scope has completed a monitoring review for the Free State of Bavaria, 31 January 2025

Applied methodologies

Sub-Sovereigns Rating Methodology, 11 October 2024

Scope Ratings GmbH

Lennéstraße 5
D-10785 Berlin
scoperatings.com

Phone: +44 20 7824 5180
Fax: +49 30 27891-100
info@scoperatings.com

in
Bloomberg: RESP SCOP
Scope contacts

Disclaimer