Land of Baden-Württemberg

Rating Report

Rating rationale and Outlook

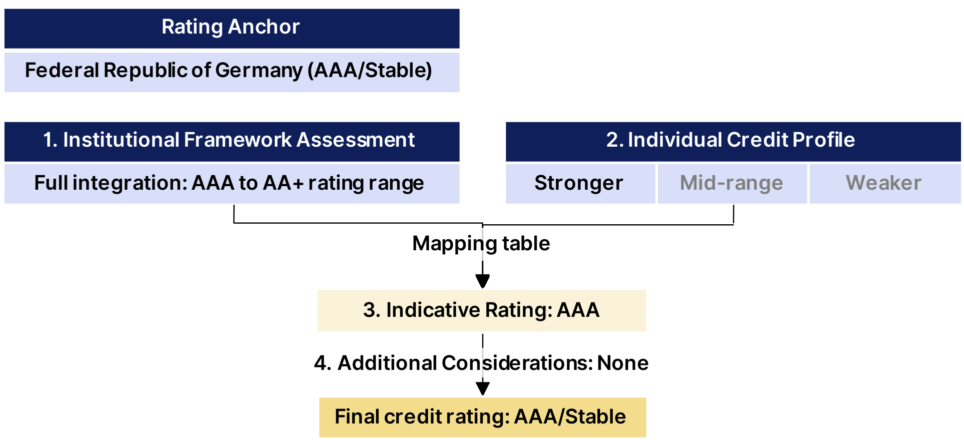
The Land of Baden-Württemberg's (Baden-Württemberg) AAA rating is driven by:

A highly integrated Institutional Framework characterised by a strong revenue equalisation system, where Baden-Württemberg 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.

A strong Individual Credit Profile, underpinned by i) solid budgetary performance and management, marked by recurring operating surpluses and a strong commitment to the debt brake, ii) conservative debt and liquidity management, with excellent capital market access and a moderate debt burden relative to other Länder, iii) a large, wealthy and diversified economy with solid growth prospects, and iv) above-average revenue flexibility, further supported by its status as a net contributor in the financial equalisation system.

Credit challenges relate to moderate budgetary flexibility given elevated spending on personnel, and high pension liabilities weighing on long-term expenditure flexibility, although these risks are partially mitigated by regular contributions to the state's pension funds.

Figure 1: Baden-Württemberg'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

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Credit strengths and challenges

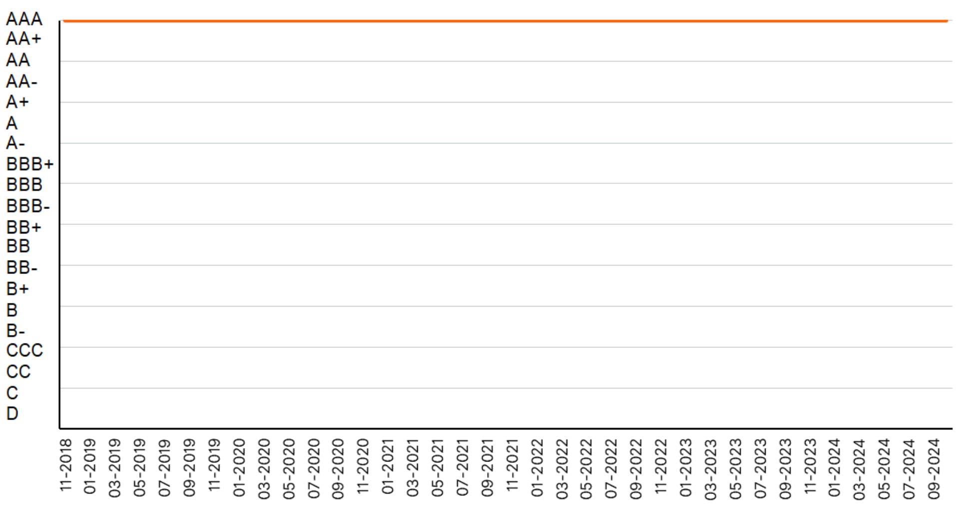
Credit strengths	Credit challenges
• Integrated institutional framework • Sound budgetary management and performance • Excellent debt and liquidity management with excellent capital market access and moderate debt burden • Large, wealthy, and diversified economy • Above-average revenue flexibility, net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

Outlook and rating triggers

The Stable Outlook reflects our 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 • Structural deterioration of individual credit profile

Figure 2: Rating history[1]



Source: Scope Ratings

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[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

Institutional framework

Federal framework results in close rating alignment…

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.

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).

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

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.

Extraordinary support and bail-out practices

Strong solidarity principle ensures extraordinary support

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.

Federal government as shock absorber during recent crises

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. This led to federal budget deficits of an average 3.3% of GDP over 2020-2022, compared with an average deficit of the Länder of 0.14% over the same period.

Ordinary budgetary support and fiscal equalisation

Comprehensive fiscal equalisation system

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. The net effect of the system change is positive for all Länder as contributions from the federal government are greater under the reformed system.

Baden-Württemberg is a net contributor to the system

Baden-Württemberg has been a net contributor to the system since the beginning. In 2023, total deductions to collected VAT amounted to EUR 4.5bn, or over 7% of operating revenue. Baden-Württemberg's contributions are the second highest in nominal terms after Bavaria (AAA/Stable).

Funding practices

Autonomous borrowing, access to shared liquidity

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

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

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 64 occasions, although not all of the 16 Länder participated. Baden-Württemberg has not participated in any of the past issues.

Fiscal rules and oversight

Debt brake anchors borrowing; stability council conducts oversight

Since 2020, the Länder have to comply with debt brakes under which they cannot run structural financing deficits unless, for example, hit by a severe economic downturn or a natural disaster.[3] The federal debt brake caps the structural annual deficit of the central government at 0.35% of GDP. 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 2020-21, Baden-Württemberg invoked the safeguard clause of its debt brake to implement support measures and credit authorisations to mitigate the impact of Covid-19.

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.

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

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.

… but no impact on Baden-Württemberg's budgetary and financial planning.

This ruling did not affect Baden-Württemberg's budgetary and financial planning. In retrospect, an external evaluation commissioned by the Land found that also in Baden-Württemberg, the transfer of the emergency loans to subsequent years was not in line with debt brake regulations. However, no re-purposing of the emergency loans occurred with all funds used for pandemic-related spending. Funds were also fully used up by the end of 2022 and by the time of the constitutional court ruling the financial years had been finalised.

Revenue and spending powers

Shared tax authority with the federal government

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.

Federal reforms strengthen political coherence

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

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.

[3] The debt brake is a legal framework that prohibits 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.

Individual credit profile (ICP)

'Stronger' ICP, leading to indicative AAA rating

We assess Baden-Württemberg's ICP as 'Stronger' relative to other German Länder, positioning its indicative rating at AAA based on our mapping table. For details, see Appendix II and Appendix III.

Baden-Württemberg's individual credit strengths include : i) solid budgetary performance, characterised by recurring operating surpluses and a strong commitment to fiscal discipline under the debt brake, ii) conservative debt and liquidity management, with excellent capital market access and a moderate debt burden relative to peers, iii) a large, wealthy and diversified 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 high pension liabilities weighing on expenditure flexibility in the long-term, although these risks are partially mitigated by regular contributions to the state's pension funds.

The Covid-19 pandemic led to a temporary budgetary deterioration in 2020 due to revenue losses and additional expenditure, as well as higher borrowing under the debt brake emergency clause. However, significant central government transfers cushioned the direct impact on budgets. Budgetary performance recovered strongly in 2021/22, allowing Baden-Württemberg to redeem EUR 942m of extraordinary pandemic borrowings early, reducing the repayment period initially committed to by almost three years.

We expect that existing budgetary reserves, the strategic use of deferred credit authorisations, and planned consolidation measures will enable Baden-Württemberg to remain compliant with the debt brake in coming years. Projected fiscal deficits reflect pressures common across Länder, driven by rising personnel costs, investment needs, and interest expenses, alongside only moderate revenue growth in the context of subdued national economic performance.

Debt and liquidity

Debt burden and trajectory

Comparatively low and stable debt levels

Baden-Württemberg's prudent debt management has contributed to a stable debt trajectory and declining debt-to-operating-revenue ratio, highlighting its commitment to fiscal prudence and sustainability.

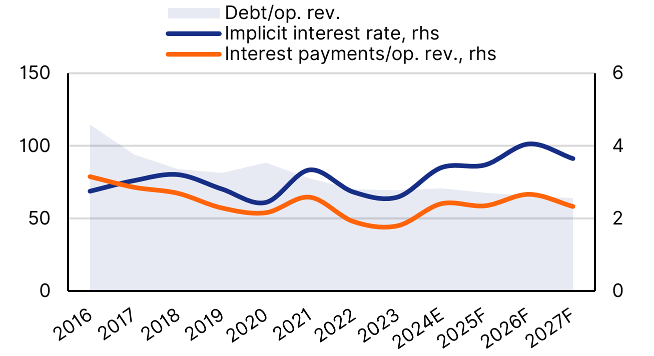
Baden-Württemberg's debt as a share of operating revenue is low compared to other Länder, with only two having lower ratios. The Land's debt of around EUR 42bn, which includes core and extra budget debt, amounted to 69% of operating revenue at YE 2023 (**Figure 3**), down from 115% at YE 2016. The improvement over this period was driven by a decrease in debt of around 21% and strong operating revenue growth which increased by around 30%.

Significant deferred credit authorisations

Unlike most other Länder, Baden-Württemberg has accumulated significant deferred credit authorisations in recent years as a result of the debt brake's cyclical component that allowed for higher borrowing due to Germany's weak economic recovery (**Figure 4**). Actual debt issuance in the Land only occurs when funds are required, which explains the substantial amounts of deferred debt being carried forward compared with other Länder.

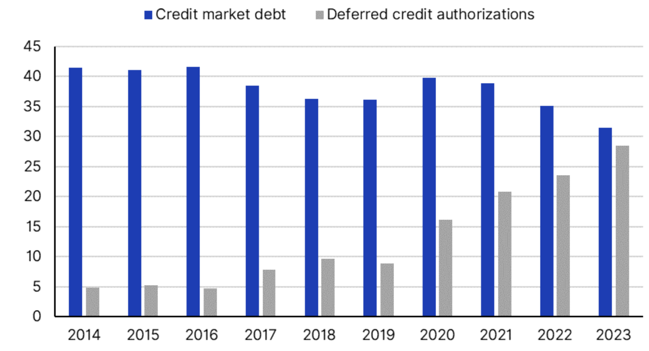
An independent review commissioned by Baden-Württemberg following the 2023 constitutional court ruling on Covid-19 emergency borrowings confirmed that the deferral of debt as practiced by the Land does not contradict debt brake rules. Most of this deferred debt is earmarked and the credit authorisations expire if not used within required timeframes.

Figure 3: Debt and interest burden, %



Sources: Land of Baden-Württemberg, Destatis, Scope Ratings. Note: Debt is adjusted for deferred borrowing.

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



* Credit market debt includes core budget debt mostly from the non-public sector.
Sources: Land of Baden Württemberg, Scope Ratings.

Commitment to the debt brake

In the near- to medium term, we expect Baden-Württemberg to continue to limit additional borrowing in line with its financial plan for 2023 to 2027. Transitional measures introduced in 2013 helped gradually lower net new borrowing, and by 2020, the debt brake was fully implemented as part of Baden-Württemberg's constitution (Art. 84), effectively prohibiting *structural* net borrowing. However, the framework retains flexibility to accommodate economic fluctuations, natural disasters and exceptional emergencies, as seen during the Covid-19 pandemic.

Stable budgetary debt until 2027, rise in core budget debt

The Land will, however, make use of deferred credit authorisations that amounted to EUR 28bn at end-2023 related to unused expenditure categories. This amount is expected to decline as annual surpluses are used in the 2025/26 budget and credit authorisations related to expenditure categories are realised in the coming years. As a consequence, statistical core budget credit market debt will gradually rise while budgetary debt is expected to stagnate close to EUR 60bn until 2027.

... but continuously strong debt/operating revenue

We expect Baden-Württemberg's debt burden to remain favourable compared with other Länder. While core budget debt is forecast to rise, the ratio of debt to operating revenue will remain relatively low.

Debt profile and affordability

Prudent debt management

Baden-Württemberg benefits from prudent debt management and its debt profile exhibits low interest-rate risks and no foreign-currency risks. Additionally, refinancing risk is remote, as for all Länder. Baden-Württemberg is distinguished by its long-term interest rate strategy, which is more forward-looking than that of its peers. This strategy, coupled with a well-structured and smooth debt redemption profile (**Figure 5**), mitigates the potential impact of rising interest rates.

Low interest rate burden

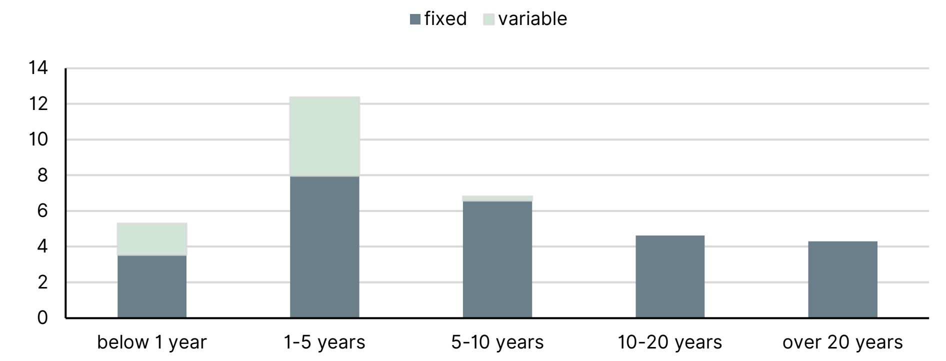
Baden-Württemberg's interest payments as a percentage of operating revenue are with 1.8% in 2023 well below the peer average of 2.3%. Drivers are the low debt level compared to operating revenue and the safe-haven status of the German Länder. Baden-Württemberg's implicit interest rate is with 2.6% in 2023 the second highest among the Länder. This results from the strategy of deferring debt issuances, which reduces the time and amount of interest to be paid, but also means that new borrowing is determined by actual funding needs and is therefore less tailored to market conditions. However, below average interest to operating revenue underlines the advantage of the debt deferrals.

Swaps mitigate interest rate and foreign exchange risk

Interest-rate and foreign currency risks are mitigated by the use of derivates. Currently, all interest rate risk is hedged. At end-September 2024, the average maturity of fixed interest rate debt (including fixed rate debt and swaps) amounted to 11.7 years. The Land targets an average maturity of around 10 years.

Figure 5: Debt profile

EUR bn



Source: Land of Baden-Württemberg, Scope Ratings

Contingent liabilities

Medium contingent liability risk

We assess Baden-Württemberg's contingent liability risk to be neutral. This is due to: i) limited contingency risk stemming from its shareholdings and guarantees; ii) ongoing provision for its pension liabilities; and iii) increasing contingent liability risk stemming from its municipalities.

Low risk from shareholdings

First, contingency risks stemming from the Land's shareholdings are low. Holdings in private companies aim to fulfil an important state interest such as securing jobs in certain regions, supporting innovation and new technologies, or to maintain essential infrastructure. In its participation strategy, the state generally observes the subsidiarity principle laid down in Section 65 (1) of the State Budget Code. One of the Land's most important holdings is EnBW Energie Baden-Württemberg AG which is managed through the NECKARPRI GmbH. Currently, EnBW is planning a capital increase of EUR 3bn, which the Land will support. Total guarantee obligations, including economic assistance, guarantees and warranties, amounted to around EUR 15.2bn at end-2023. The long-term loss rate of the state from all guarantees is low at around 0.5%.

High unfunded pension liabilities, gradual build-up of reserves

Second, in line with other Länder, Baden-Württemberg has unfunded pension liabilities related to its civil servants. With the 'Versorgungsrücklage' and the 'Versorgungsfonds' the Land set up two special funds to partially cover its future pension obligations. The 'Versorgungsrücklage' was established in 1998 and amounted to EUR 4.5bn at end-2023, while the 'Versorgungsfonds' was launched in 2007 and amounted to around EUR 6.9bn. Hence, total reserves related to future pension obligations stood at around EUR 11.4bn at end-2023 and are expected to increase to around EUR 18bn by end-2027. These assets stand against pension provisions that amounted to EUR 172bn at end-2022, resulting in a funding ratio of 6.6%. When comparing total reserves to annual pension payments, Baden-Württemberg's coverage is broadly in line with that of other Länder.

High spending pressures in municipalities

Finally, contingent liability risks stem from the Land's municipalities. While municipalities in Baden-Württemberg have one of the lowest per capita debt burdens among the German Bundesländer, they recorded the highest increase in 2023. In May 2024, the municipalities threatened the Land with a lawsuit given structurally rising costs that are mainly dictated by federal or state law. This includes increased spending on housing and the integration of refugees, expenditures on hospitals, and all-day supervision in elementary schools.

Liquidity position and funding flexibility

Baden-Württemberg's liquidity management is prudent and supported by appropriate inter-year cash planning, diverse liquidity sources, and ample reserves. Its market access is assessed as excellent.

Cash flows, especially inflows, are prone to seasonal variability driven by the tax calendar. 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.

Diverse liquidity sources, ...

The forward-looking and timely liquidity planning supports the budgetary planning in saving interest payments on deferred debt. The specificity of the deferred debt also implies that reserves mainly exist in the form of credit authorisations implying that in the case of usage, the debt would first need to be issued in capital markets. In combination, prudent planning, diversification of sources, and strong market access render the risk of liquidity shortages negligible.

... forward-looking liquidity planning, and reserves support the liquidity position.

Finally, Baden-Württemberg's funding access is excellent. Debt issuance on capital markets is expected to reach around EUR 7bn in 2024, including EUR 3.4bn in floating rate notes and EUR 3bn in fixed rate bonds. The Land issued its first green bond in 2021 with a volume of EUR 300m and has since continued to issue one green bond every year. The 2024 bond is expected to be priced in October with an issuance volume of EUR 650m.

Strong market access as a financially stronger Land...

We generally view ESG-bond issuance as credit positive, as it increases the capital market presence and visibility as an issuer and widens the Land's investor base. Baden-Württemberg's green bond framework is in compliance with the ICMA Green Bond Principles and aligned with the environmental objectives of the EU Taxonomy and the UN Sustainability Goals.

... supported by green bond issuance.

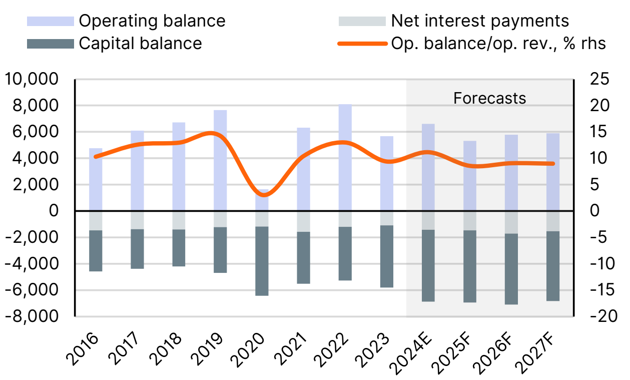
Budget

Budgetary performance and outlook

Baden-Württemberg displayed robust budgetary performance between 2016 and 2019, with operating margins averaging 12.5% of operating revenues (**Figure 6**). This was in line with other Länder given an accommodative monetary and economic backdrop and consolidation efforts before the implementation of the debt brake at state level in 2020. Operating surpluses supported the Land's ability to cover interest payments and capital expenditure without additional borrowing.

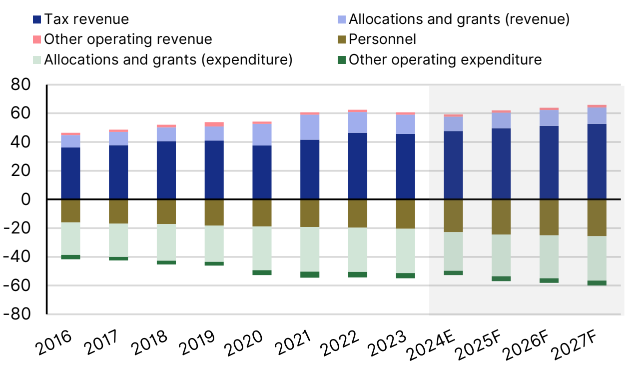
Track record of solid budgetary performance, fiscal surpluses until 2019

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



Sources: Land of Baden-Württemberg, Destatis, Scope Ratings

Figure 7: Components of operating balance, EUR bn



Sources: Land of Baden-Württemberg, Destatis, Scope Ratings

From 2020, the Covid-19 shock impacted budgetary planning and fiscal outcomes. A drop in tax revenues of over 8% coupled with an increase in operating expenditures of 14%, mostly driven by higher transfer expenditure, led to a deterioration in the operating balance. In combination with an increased capital deficit, the Land's core budget balance turned to a deficit (before debt movement) of EUR 4.8bn, or 8.7% of total revenue in 2020. To finance any Covid-19 related measures, Baden-Württemberg borrowed EUR 8.1bn in 2020-21 under the debt brake's emergency safeguard clause. Debt taken on under the clause must be redeemed under mandatory rules, with originally planned annual redemption payments of EUR 325.6m starting in 2024.

Covid-19 crisis led to a deficit in 2020

In 2021, the budgetary performance recovered strongly, driven by an 11.9% growth in operating revenue in combination with a growth of 3.4% in operating expenditures. Recovery continued in 2022, bringing the balance before debt movement/total revenue up to 4.4%, after 1.3% in 2021. The recovery was driven by an increase of tax revenues of 11% and 12%, in 2021 and 2022, respectively. This allowed the Land in 2022 to redeem EUR 942m of extraordinary Covid borrowings early, reducing the repayment period initially committed to by almost three years.

Budgetary performance recovered strongly in 2021/22

In 2023, the budgetary performance deteriorated compared with the previous year amid weakening economic growth. Tax revenues were EUR 600m lower than budgeted, driving a decline in operating revenue of 2.9%. The balance before debt movements ended in a deficit of EUR 134m. However, as some planned expenditure was not incurred during the year, an accounting surplus of EUR 2.3bn was ultimately recorded for 2023, of which EUR 1.8bn could be used to ease the consolidation pressure in the 2025/26 draft budget. Similarly, a surplus of EUR 4.7bn was recorded in 2022, also easing pressures in the draft budget.

Budgetary deterioration in 2023, tax revenue below budgeted levels

Developments until the end of the third quarter 2024 are broadly in line with expectations. Despite the challenging economic backdrop, tax revenues have been supported by a tight labour market and staff shortages, resulting in revenues becoming less closely linked to the economic cycle in recent years. There remains some uncertainty whether this trend will continue as firms are facing rising cost pressures and the unemployment rate has started to increase.

Developments in 2024 broadly in line with expectations

Accounting surpluses from prior years created some headroom for the 2025/26 draft budget. Furthermore, positive effects from the census 2022 will lead to additional revenue over the next years. However, some consolidation measures are still required to close the structural funding gap. These measures include a reduction in the previously planned allocations to the pension reserve and an extension of the repayment period of pandemic-related redemptions back to the originally committed 25 years.

Budget 2025/26 benefits from past accounting surpluses and census results

We expect Baden-Württemberg to continue to adhere to its commitment to the debt brake. At the same time, deferred credit authorisations create some room for new – though mostly earmarked – credit market debt. Adequate reserves will support the budget in the upcoming years, but structural spending pressures will make balancing budgets increasingly difficult.

Revenue flexibility

As for all German Länder, Baden-Württemberg'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.

Länder have overall moderate revenue flexibility…

However, vis-à-vis peers, Baden-Württemberg enjoys above-average flexibility as a net payer to the financial equalisation system. The share of transfers to operating revenue is in line with the Länder average.

… but Baden-Württemberg enjoys above-average flexibility.

Expenditure flexibility

Baden-Württemberg's expenditure flexibility is restricted by a high share of personnel expenditure amounting to 37.3% of total expenditure in 2023, and further expenditure required by federal and state legislation and other legal obligations. This also encompasses transfer expenditure, including to the municipalities. Given that all German Länder face the same challenge, Baden-Württemberg's expenditure flexibility is in line with the Länder average. Capital expenditure amounted to 9.8% of total expenditure in 2023. In line with all other Länder, pressures on the expenditure side are expected to increase in the coming years.

Limited expenditure flexibility given high personnel and transfer expenditure

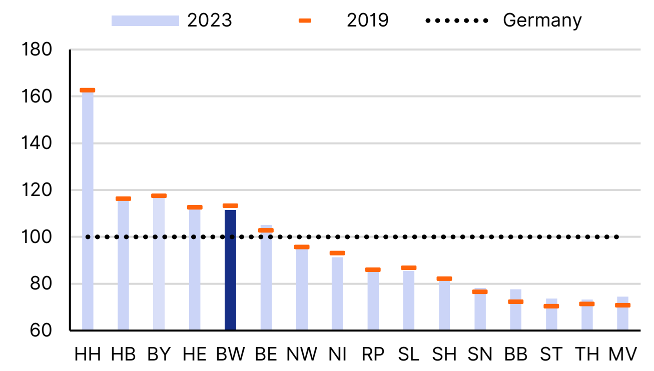
Economy

Wealth levels and economic resilience

Baden-Württemberg's economic profile is relatively strong

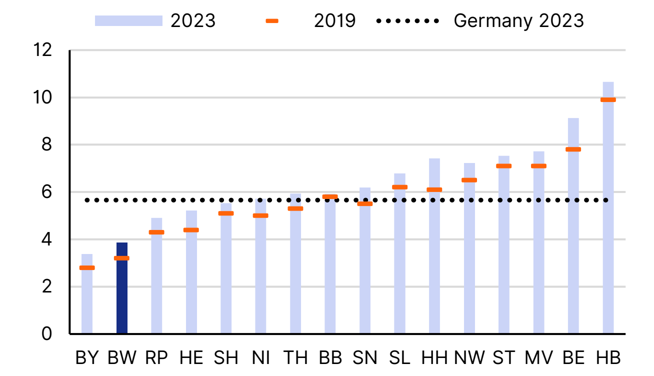
Baden-Württemberg's economic profile is relatively strong compared to peers, with a higher GDP per capita than the German average (**Figure 8**). It is the third largest Land in Germany in terms of geography, population and economic output, contributing almost 15% of national GDP in 2023. In 2021 and 2022, Baden-Württemberg's real GDP increased faster than the German average, though the economic contractions in 2020 and 2023 were also more pronounced. In 2023, Baden-Württemberg's economy contracted by 0.6%, versus a drop in real GDP of 0.3% in Germany. The Land's strong long-term economic performance is reflected in the fact that Baden-Württemberg has been a continuous contributor to the federal equalisation system since its introduction.

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

Historically strong manufacturing sector

Baden-Württemberg benefits from a strong manufacturing sector compared with other Länder. In 2023, the sector accounted for almost 40% of total gross value added vs. a Länder average of around 30%. As for all Länder, reliance on services remains high with around 60% of gross value added.

Strong export region

Baden-Württemberg is a strong export region, with the highest export volume across the Bundesländer. Motor vehicles and motor vehicle parts, machinery and pharmaceutical products together account for around half of total exports. However, stronger export dependency compared to other Länder is also the reason for more volatile GDP developments in recent years. In H1 2024, exports declined significantly in the three key industrial sectors and to main trading partners such as China and Italy. Heightened geopolitical risks, elevated energy prices, increasing competitiveness of some trading partners, and pressures related to an ageing population weigh on future growth prospects.

Economic sustainability

Land proactively addresses transition challenges and supports innovation

The green and digital transition creates challenges for Baden-Württemberg, especially for the key automotive industry. To address this transition, the government has created the Strategic Dialogue for the Automotive Sector BW bringing together all relevant actors. Beyond the automotive sector, a range of projects and initiatives (e.g. Start-up BW, EXIST-Potentiale, Roadmap Wasserstoff, the Fachkräfteallianz) work to ensure the region's innovative strength and economic dynamism.

Small and medium-sized enterprises, also referred to as the 'Mittelstand', are the backbone of the economy in Baden-Württemberg. The government is supporting these firms with a range of measures aimed at reducing bureaucracy. Compared with several large companies, the

'Mittelstand' is often able to adapt faster to global market trends and has started to tackle some key transformations such as the digital and green transition in a timelier manner.

Historically low unemployment

Baden-Württemberg has the second lowest unemployment rate among the German Länder, after Bavaria. It stood at 3.9% in 2023, compared to 5.7% at the national level (**Figure 9**), rising slightly to 4.3% in September 2024. Recent announcements of large automotive companies and automotive suppliers to cut back production, potentially close plants or abolish previous job guarantees create some uncertainties in the labour market.

Finally, we assess Baden-Württemberg's medium-term growth potential to be in line with the potential of Germany at 0.8%. The diverse industrial base could lead to growth opportunities, such as in the pharmaceutical sector, while uncertainty stems from Baden-Württemberg's greater dependency on exports.

Governance

Governance and financial management

Stable government; next elections in spring 2026

After the last regional elections in May 2021, the CDU and the Greens are in a coalition with Winfried Kretschmann as minister president who has been in office since 2011. We expect broad policy continuity. Next elections will be held in spring 2026.

Administration committed to financial consolidation

The state government's track record of formulating and implementing fiscal policy targeted at long-term fiscal sustainability has been highlighted since the Covid-19 shock in 2020. The state made support available quickly using emergency funds and subsequently worked towards a swift return to fiscal consolidation. Authorities will face the challenge of balancing future budgets by tightly controlling spending in coming years. Consolidation needs of around EUR 430m annually ('globale Minderausgaben') have been identified for 2024-27 on the spending side.

Finally, we deem Baden-Württemberg's debt and liquidity management as comprehensive and effective, in line with the high governance standards of the German Länder.

Environmental and social considerations

Environmental factors and resilience

Transition and physical climate risks broadly in line with German average

Regarding exposure to transition and physical risks, we see Baden-Württemberg as broadly in line with the nationwide average. Baden-Württemberg's economic structure is relatively less reliant on energy-intensive industry and does not face costs related to the phase-out of coal, like some other Länder. However, the automotive industry, one of the Land's key sectors, is strongly affected by the green transition and its transformation will require significant efforts over the coming years.

Baden-Württemberg aims to be carbon neutral by 2040

Climate protection has been regulated through a separate law in Baden-Württemberg since 2013. The Land was the second federal state with such a climate protection law, after North Rhine-Westphalia, and last updated and further developed it in 2023. The state aims to be carbon neutral by 2040, i.e. five years earlier than the federal state. To set a good example, the regional administration is expected to be carbon neutral by 2030.

With the Climate Protection and Climate Change Adaption Act, i.e. the 2023 update, Baden-Württemberg introduced specific greenhouse gas emission reduction targets by sector in order to improve transparency. It is the first Bundesland to do so and thereby clearly demonstrates its commitment to the goals.

Pioneering role regarding sustainability

To anchor the concept of sustainability in politics, business and society Baden-Württemberg kickstarted its sustainability strategy in 2007. With the realignment of the strategy in 2011, it also encompasses the aspiration to make sustainability the central decision-making criterion for government and administrative action. This is supported by the regular issuance of a green bond every year since 2021, with the next issuance planned for October 2024.

Social factors and resilience

An ageing population is a key social risk, but Baden-Württemberg is moderately affected

A key risk related to social factors across Germany is the ageing population and shortage of skilled workers. Baden-Württemberg’s old age dependency ratio at YE 2022 (persons aged 65 and over relative to persons aged 15-64) of 32.3% lies below the ratio across Germany of 34.7%.

Projections indicate an increase of the Land’s population of 4.6% until 2040, driven by continued immigration, well above the national average of 0.6%. The demographic pressures are evident in the share of the population aged 65 to 79, which is set to rise by almost 35% from 13.8% in 2020 to 17.8% in 2040. The rising share of pensioners will have to be supported by fewer working-age people (those aged 25 to 64) which are projected to decrease by 7%. Population changes vis-a-vis peers are crucial for financial equalisation and other flows, with a moderately positive effect expected for Baden-Württemberg if the relatively favourable demographic trends materialise.

Education, national security and innovation are key priorities

The draft budget 2025/26 illustrates the prioritisation of education, along with national security and innovation. The plans include increased support for municipalities of EUR 700m to help fund the all-day supervision in elementary schools, 650 new police officers to improve security, and support for the University of Stuttgart and the Health and Life Science Alliance to strengthen innovation.

Appendix I. 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 II. 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	80
Indicative notching	0

Appendix III. Mapping table

We derive the indicative rating by mapping the result of the institutional framework assessment to the ICP score. For Baden-Württemberg, 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

	2018	2019	2020	2021	2022	2023	2024E	2025F	2026F
Budgetary performance (EUR m)									
Operating revenue	51,924	53,816	54,285	60,741	62,353	60,547	59,328	62,148	63,913
Operating revenue growth, %	6.9%	3.6%	0.9%	11.9%	2.7%	-2.9%	-2.0%	4.8%	2.8%
Tax revenue	40,586	40,915	37,628	41,591	46,410	45,618	47,530	49,645	51,130
Allocations and grants	9,576	9,877	14,996	17,417	14,336	13,404	10,125	10,832	11,116
Other operating revenue	1,762	3,024	1,662	1,733	1,606	1,526	1,673	1,671	1,667
Operating expenditure	45,208	46,168	52,634	54,425	54,263	54,877	52,723	56,838	58,132
Operating expenditure growth, %	6.4%	2.1%	14.0%	3.4%	-0.3%	1.1%	-3.9%	7.8%	2.3%
Personnel	17,142	18,174	18,747	19,136	19,541	20,457	22,757	24,370	24,995
Allocations and grants	25,512	25,237	30,566	31,255	30,902	30,830	26,996	29,234	29,888
Other operating expenditure	2,555	2,757	3,321	4,034	3,821	3,590	2,970	3,234	3,249
Operating balance	6,716	7,648	1,652	6,316	8,090	5,671	6,605	5,310	5,781
Interest received	4	2	3	2	2	2	2	1	1
Interest paid	1,398	1,231	1,170	1,570	1,193	1,086	1,428	1,460	1,703
Net interest paid	1,394	1,230	1,168	1,568	1,191	1,084	1,426	1,459	1,702
Current balance	5,322	6,419	484	4,748	6,898	4,586	5,179	3,851	4,079
Capital balance	-2,818	-3,468	-5,268	-3,946	-4,071	-4,720	-5,441	-5,485	-5,391
Balance before debt movement	2,504	2,951	-4,785	802	2,827	-134	-262	-1,634	-1,312
New borrowing (credit market)	3,294	2,771	7,501	1,800	350	1,300	7,112	7,096	6,383
Debt redemption (credit market)	5,428	2,943	3,864	2,658	4,202	4,901	4,068	3,779	3,079
Change in deferred credit authorisations	1,885	-828	7,290	4,551	2,893	4,853	-3,237	-3,500	-3,500
Net borrowing (core budget)	-250	-1,000	10,926	3,693	-958	1,253	-193	-183	-196
Debt (EUR m)									
Direct debt	43,595	43,809	47,989	47,050	43,758	42,024	45,068	48,385	51,689
Guarantees	11,743	12,040	11,989	11,988	14,503	15,100	15,100	15,100	15,100
Overall debt risk (direct debt plus guarantees)	55,338	55,849	59,978	59,038	58,261	57,124	60,168	63,485	66,789
Financial ratios									
Debt/operating revenue, %	84.0%	81.4%	88.4%	77.5%	70.2%	69.4%	76.0%	77.9%	80.9%
Debt/operating balance, years	6.5	5.7	29.1	7.4	5.4	7.4	6.8	9.1	8.9
Interest payments/operating revenue, %	2.7%	2.3%	2.2%	2.6%	1.9%	1.8%	2.4%	2.3%	2.7%
Implicit interest rate, %	3.2%	2.8%	2.4%	3.3%	2.7%	2.6%	3.2%	3.0%	3.3%
Operating balance/operating revenue, %	12.9%	14.2%	3.0%	10.4%	13.0%	9.4%	11.1%	8.5%	9.0%
Balance before debt movement/total revenue, %	4.7%	5.4%	-8.7%	1.3%	4.4%	-0.2%	-0.4%	-2.6%	-2.0%
Transfers and grants/operating revenue, %	18.4%	18.4%	27.6%	28.7%	23.0%	22.1%	17.1%	17.4%	17.4%
Capital expenditure/total expenditure, %	8.3%	8.9%	10.2%	8.2%	9.4%	9.8%	10.3%	9.8%	9.6%
Economy and demographics									
Nominal GDP, EUR m	516,670	525,421	509,020	539,369	576,128	615,071			
GDP per capita, EUR	46,772	47,399	45,851	48,531	51,429	54,339			
GDP per capita, % of national GDP per capita	115.2%	113.4%	112.0%	111.6%	111.2%	111.5%			
Real GDP growth, %	2.2%	-0.4%	-4.8%	4.0%	2.2%	-0.6%			
Population, '000s	11,070	11,100	11,103	11,125	11,280	11,339			
Unemployment rate, % labour force	3.2%	3.2%	4.1%	3.9%	3.5%	3.9%			

Note: Data on budgetary performance is shown as reported in Destatis to allow for comparability across Länder. Only new borrowings and debt redemptions are adjusted by deferred credit authorisations. In 2018, adjustments are equally made to exclude credit lines ('Kreditrahmen') in addition to deferred credit authorisations.
Source: Land of Baden-Württemberg, Destatis, Statistische Ämter des Bundes und der Länder, Scope Ratings

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