Federal Republic of Germany
Rating Report

AAA STABLE OUTLOOK

Credit strengths

- Wealthy, large, diversified economy
- Robust fiscal framework and strong track record of fiscal discipline
- Highly competitive external sector

Credit challenges

- Transition risks for energy-intensive industries, and low levels of public and private sector investment
- Ageing population, resulting in rising pension liabilities and lower growth potential

Rating rationale

Wealthy, large, diversified economy: Germany's economy proved resilient during the Covid-19 pandemic. However, the country's high value-added, export-oriented, energy imports-dependent economy has been slow to recover compared with peer countries due to global supply chain disruptions and sharply higher inflation following the escalation of the Russia-Ukraine war.

Robust fiscal framework: Germany's solid fiscal policy framework and strong record of fiscal discipline are anchored by its constitutional debt brake. The debt brake has been reinstated for 2023, although greater use of special extra-budgetary funds will raise general government deficits above debt brake limitations over coming years.

Highly competitive external sector: The economy's external strength is reflected in its large and persistent current account surplus. This declined in 2022 due to the sharp rise in energy import prices and weaker external demand from key trading partners. The surplus is expected to remain slightly below pre-pandemic levels in the medium term.

Rating challenges include: i) transition risks for energy-intensive industries given carbon neutrality targets and low levels of public and private sector investment relative to peers; and ii) an ageing population, resulting in rising pension liabilities and downward pressure on the country's medium-term growth potential.

Germany's sovereign rating drivers

Risk pillars		Quantitative		Reserve currency	Qualitative*	Final rating
		Weight	Indicative rating	Notches	Notches	
Domestic Economic Risk		35%	aaa	EUR [+1]	-1/3	AAA
Public Finance Risk		20%	aa		+1/3	
External Economic Risk		10%	aaa		+2/3	
Financial Stability Risk		10%	aaa		+1/3	
ESG Risk	Environmental Factors	5%	a-		-1/3	
	Social Factors	7.5%	b		0	
	Governance Factors	12.5%	aaa		0	
Indicative outcome		**aaa**			**+1**	
Additional considerations					**0**	

* Note: The qualitative scorecard adjustments, capped at one notch per rating pillar, are weighted equally with an aggregate adjustment rounded to the nearest integer. The reserve currency adjustment applies to currencies in the IMF's SDR basket. For details, please see Scope's Sovereign Rating Methodology. Source: Scope Ratings

Outlook and rating triggers

The Stable Outlook reflects our view that risks to the ratings are balanced.

Positive rating-change drivers

- N/A

Negative rating-change drivers

- Fiscal deterioration, resulting in a material increase in public debt
- Significant deterioration in the country's growth potential and/or outlook

Ratings and Outlook

Foreign currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

Local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

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Bloomberg: RESP SCOP

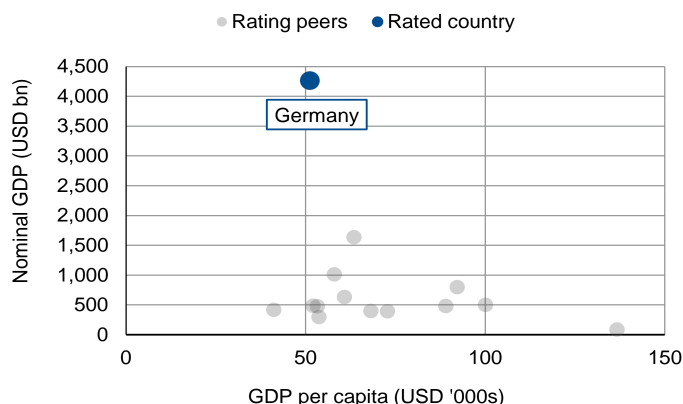
Domestic Economic Risks

- **Growth outlook**: Germany's post-pandemic recovery has been relatively slow when compared with peer countries as global supply chain disruptions held back industrial output and sharply higher inflation following the escalation of the Russia-Ukraine war slowed consumption growth. As such, economic momentum remained subdued in 2022 with GDP increasing by 1.8% and total output slightly below pre-pandemic levels at the end of the year, while most other highly rated countries and the Euro Area as a whole have seen stronger rebounds. Despite order books remaining full, continued supply chain limitations for intermediate products, high energy prices and labour shortages are all holding back production. We expect low growth of 0.2% in 2023 as falls in real incomes depress investment spending and consumption, before accelerating to 1.7% in 2024. An ageing population and low levels of investment mark material headwinds for the long-term growth potential, which we estimate at 0.9%.
- **Inflation and monetary policy**: Headline HICP inflation peaked at 11.6% YoY in October 2022 driven by a rise in energy prices and rising input costs, but it has since fallen to 7.6% in April 2023. Headline inflation is expected to decline further as the pass-through of high energy prices will be mitigated by electricity price caps introduced by the government. However, inflationary pressures remain exceptionally high and have broadened in recent months with core HICP inflation at 5.6% in April, still close to its highest level since records began in 1997. Like other major central banks, the ECB has been rapidly tightening its monetary policy to tame price pressures. Key ECB interest rates increased sharply, with the deposit rate reaching 3.0%. This is the highest level since 2008 and 350 bps higher than in 2019. We expect the speed of monetary tightening to slow in 2023.
- **Labour market**: The German labour market has proved to be resilient despite slower economic momentum, with the unemployment rate remaining near historically low levels of around 3%. The employment rate is elevated at 77.3% as of Q4 2022, 0.3 pp above its end-2019 level. We expect the labour market to remain tight in the medium term, with the unemployment rate averaging 3.0% this year and 2.9% in 2024. This is despite recent, more moderate employment gains and a gradual decline in unfilled vacancies. While wage negotiations have led to salary increases, price rises have outpaced nominal wages, causing real earnings to decline since Q3 2021.

Overview of Scope's qualitative assessments for Germany's *Domestic Economic Risks*

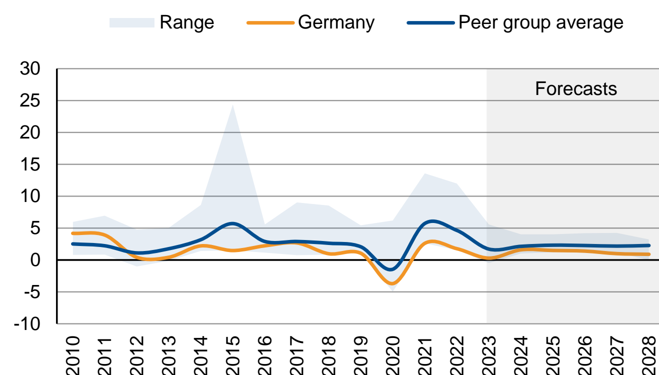
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Growth potential of the economy	Weak	-1/3	Weak growth potential, reflecting large investment gap and structural challenges in key industries
	Monetary policy framework	Neutral	0	ECB is a highly credible and effective central bank; effective policy framework and transmission over the cycle
	Macroeconomic stability and sustainability	Neutral	0	Competitive and diversified economy but weaknesses in digitalisation, labour market challenges related to ageing; high resource dependence and trade linkages with other countries

Nominal GDP and GDP per capita, USD



Source: IMF World Economic Outlook (WEO), Scope Ratings

Real GDP growth, %



Source: IMF WEO, Scope Ratings forecasts

Public Finance Risks

- **Fiscal outlook**: Federal and state debt-brake laws, introduced for the federal government in 2009 and binding for state governments since 2020, limit structural deficits to 0.35% of GDP a year for the federal government and 0% for state governments. The debt brake was suspended at the onset of the Covid-19 crisis and again after the escalation of the Russia-Ukraine war, enabling the government to fund large budgetary measures. Public funds allocated to mitigate the energy crisis' impact on the private sector are estimated at EUR 264bn (6.8% of 2022 GDP) between September 2021 and January 2023, the largest support package among euro area countries. We expect the headline budget deficit, including extra-budgetary spending, to remain elevated at 3.9% of GDP in 2023 and 2.7% in 2024, up from 2.6% last year, before gradually falling to around 1.0% by 2028. While the government is committed to reimplementing the debt brake from 2023, the use of special funds, with spending spread over several years, will increase government deficits. This includes additional planned borrowing of EUR 100bn to boost military spending and up to EUR 200bn to cushion rising energy prices for households and businesses.

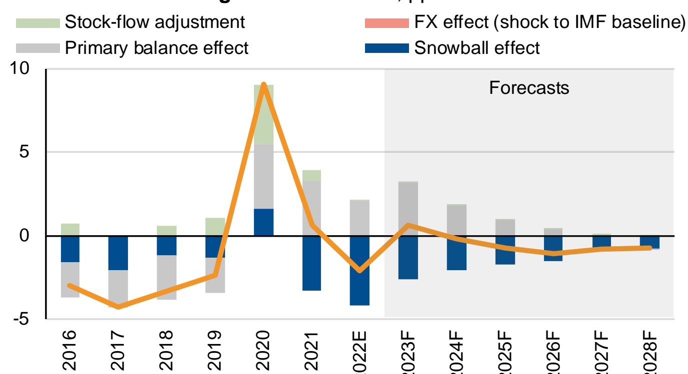
- **Debt trajectory**: Strict fiscal discipline, underpinned by a robust fiscal framework, allowed for a sharp decline in the debt-to-GDP ratio in the decade leading up to the pandemic, from 82% to 59% over 2010-19. Unprecedented fiscal support measures during the pandemic and energy crisis led to a sharp jump in debt levels, which are expected to increase to 67.2% of GDP this year. We expect the debt-to-GDP ratio to gradually trend down starting from next year, declining from 67% in 2023 to around 64% by 2028.

- **Market access**: Germany's market access continues to be very strong, underpinned by its status as the euro area's benchmark issuer. In line with other advanced economies and amid rising inflationary pressure, funding costs have increased sharply since early 2022. Yields on 10-year bonds averaged 2.4% in April 2023, up from 0.8% over the same period last year, although stabilising in recent months. The debt structure is favourable, with a marginal share of inflation-linked securities making up just 3.6% of the total outstanding volume and no foreign currency exposure. Weighted average maturity has gradually increased in recent years, rising from around 5.4 years in 2013 to 7.7 years as of March 2023. Gross issuances are expected to amount to EUR 544.25bn this year (13.4% of GDP), including continued green bond issuances under the twin bond framework.

Overview of Scope's qualitative assessments for Germany's *Public Finance Risks*

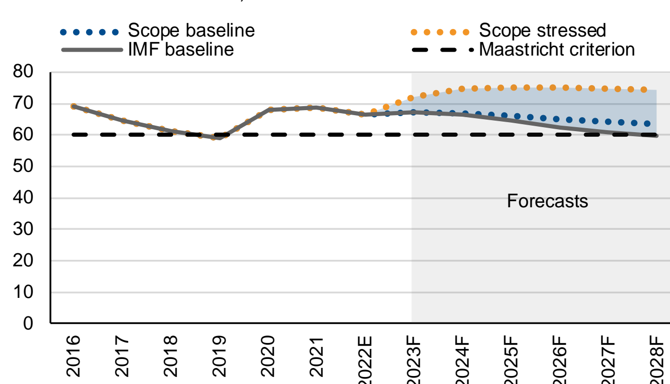
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aa-	Fiscal policy framework	Neutral	0	Strong policy response to energy crisis; constitutionally anchored debt brake at federal and regional level, contributing to retention of fiscal space but increased use of extra-budgetary special funds
	Debt sustainability	Neutral	0	Moderate public debt with high resilience to adverse scenarios; rising pension liabilities
	Debt profile and market access	Strong	+1/3	Primary benchmark issuer in euro area, reflected in low interest payments despite heightened debt levels

Contributions to changes in debt levels, pp of GDP



Source: IMF WEO, Scope Ratings forecasts

Debt-to-GDP forecasts, % of GDP



Source: IMF WEO, Scope Ratings forecasts

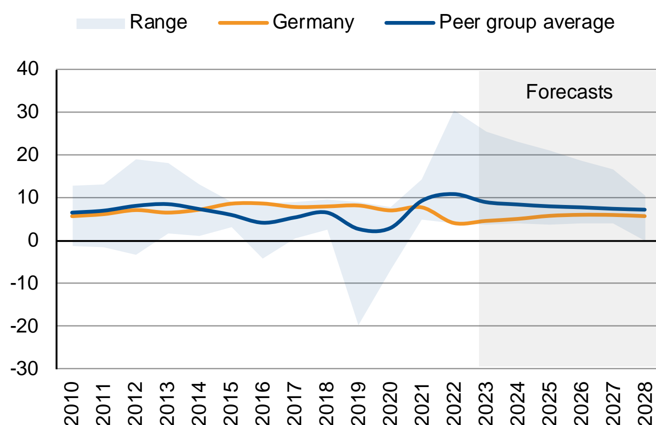
External Economic Risks

- **Current account**: The German economy's external strength is reflected in its very large, persistent current account surpluses, averaging 7.7% of GDP in the 10 years till 2021. The escalation of the Russia-Ukraine war and the associated sharp rise in energy import prices, as well as weaker external demand from key trading partners including China, exerted significant downward pressure on the trade balance in 2022. This caused the current account balance to fall to 4.2% of GDP in 2022, its lowest level since 2003 and the biggest decline since German reunification. While the goods trade balance was the main driver of the decline, the services balance also deteriorated. This was mainly due to the normalisation of cross-border travel after two years of low activity due to pandemic-related travel restrictions. We expect some of these headwinds to continue to weigh on Germany's current account balance in the medium term, with the balance gradually returning to about 6% by 2026.
- **External position**: Germany's net international investment position (NIIP) amounted to EUR 2.7trn (70% of GDP) at end-2022. German claims on non-residents now stand at EUR 12.0trn while German liabilities amount to EUR 9.2trn. Persistent, large current account surpluses have supported the NIIP, which has continued a steady upward trend in line with other peer countries, rising from around 17% of GDP in 2011. External debt is moderate and declined from a recent high of 171% of GDP in Q4 2021 to about 156% in Q4 2022, therefore remaining around 9 pp above its end-2019 level.
- **Resilience to shocks**: Like all euro area members, Germany benefits from the euro's status as a global reserve currency, significantly mitigating risks to external shocks. The more challenging global environment resulted in increased demand for safe assets among investors. Germany's net external assets increased by EUR 220bn in 2022, mainly driven by an increase in direct investments (EUR 125bn) while portfolio investments, financial derivatives and other investments also rose.

Overview of Scope's qualitative assessments for Germany's *External Economic Risks*

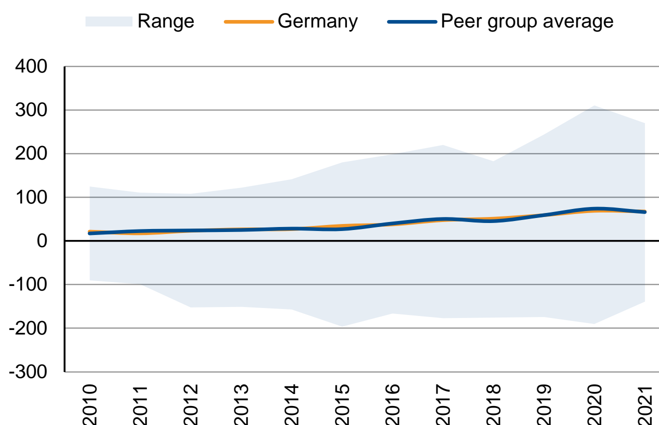
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Current account resilience	Strong	+1/3	Diversified and competitive export base; strong track record of current account surpluses
	External debt structure	Neutral	0	Moderate external debt
	Resilience to short-term external shocks	Strong	+1/3	Benefits from euro area membership; large external-creditor position

Current account balance, % of GDP



Source: IMF WEO, Scope Ratings

Net international investment position (NIIP), % of GDP



Source: IMF, Scope Ratings

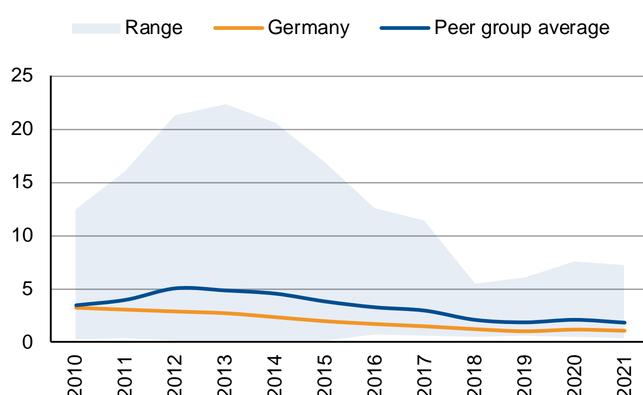
Financial Stability Risks

- **Banking sector**: German banks are highly liquid and adequately capitalised, as reflected in a liquidity coverage ratio of 154%, and an average Tier 1 ratio of 17% as of Q4 2022, in line with the EU average of 16.8%. The sector's resilience is supported by strong asset quality. While the share of Stage 2 loans under IFRS 9 remains elevated at 9.9%, the share of Stage 3 loans is still below pre-pandemic levels and the level of non-performing loans is also low and stable at 1.1% of gross loans in Q4 2022 according to the European Banking Authority. The sector has faced structurally weak profitability in the past, with the aggregate sector return on equity averaging 2.2% over 2015-19 – the lowest level among similarly rated peers due to cost pressures and low interest rates. Rising interest rates supported profitability in 2022, with aggregate return on equity reaching 6% in Q4 2022, the highest level on record since 2014. The weak economic outlook will weigh on credit demand and asset quality, but we expect rising interest rates to support higher interest margins in the medium term.
- **Private debt**: Private sector leverage remains low relative to peer countries. Household and non-financial corporate debt levels amounted to 56% and 73% of GDP as of Q3 2022, being well below other AAA rated countries and lower than the euro area averages of 58% and 109%, respectively. Low debt service ratios and long fixed interest rate periods for housing loans provide a higher buffer to the rising interest rate environment than many peer countries.
- **Financial imbalances**: Real estate prices grew rapidly in recent years, driven by structural demand pressures and supply shortages. According to the Association of German Pfandbrief Banks, house prices peaked in Q2 2022. Commercial real estate prices have since fallen 3.9% by Q4 2022, while residential house prices are 4.0% lower as transaction volumes have fallen sharply to a decade low. The price correction to date is relatively mild given strong price rises since the onset of the pandemic in commercial (5%) and residential (22%) real estate. To increase resilience, the national regulator introduced a 2% systemic risk buffer on housing loans and the countercyclical capital buffer rate was raised to 0.75% (effective 1 February 2023). While we expect the housing market to cool over the coming months as mortgage rates rise, related risks appear to be contained in view of continued housing shortages, high amortisation rates, a prevalence of fixed-rate mortgages and a high proportion of renters relative to other countries.

Overview of Scope's qualitative assessments for Germany's *Financial Stability Risks*

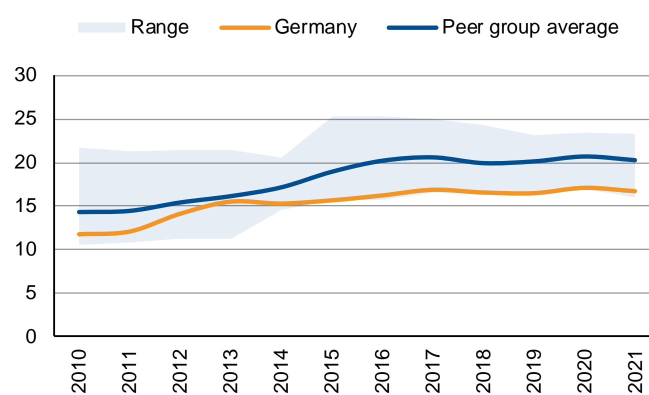
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
aaa	Banking sector performance	Neutral	0	Low profitability and unfavourable cost structure of banking sector balanced by adequate capitalisation and moderate exposure risk to non-financial corporate debt
	Banking sector oversight	Neutral	0	Oversight under National Supervisory Authority and ECB as part of banking union
	Financial imbalances	Strong	+1/3	Moderate household and private sector indebtedness; closely monitored systemic risks in financial system

Non-performing loans, % of total loans



Source: IMF, EBA, Scope Ratings

Tier 1 ratio, % of risk-weighted assets



Source: IMF, Scope Ratings

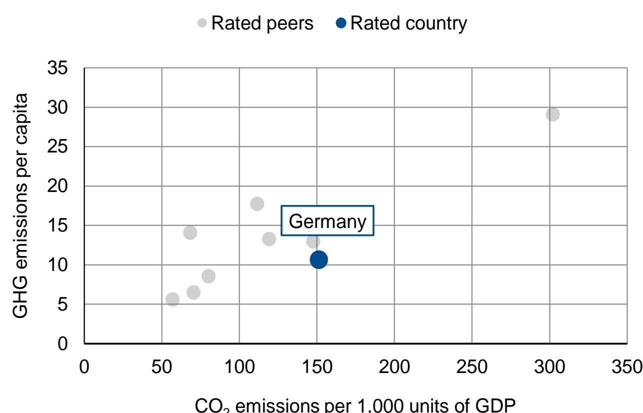
ESG Risks

- **Environment**: Despite having achieved material progress in developing renewable energy production capacities over recent decades, Germany remains largely reliant on fossil fuels, which accounted for 78% of primary energy consumption in 2021 compared to around 70% in the EU. The escalation of the Russia-Ukraine war has prompted the government to accelerate the country's transition away from fossil fuels and strengthen its energy security, including additional investments and relaxed planning rules. The government aims to reach climate neutrality by 2045 through an accelerated phase-out of coal and a rapid scale-up of renewable sources of energy, which are to cover 80% of the country's electricity needs by 2030 (currently at around 49%). Meeting these ambitious targets will require continued, rapid structural changes to keep up with other highly rated economies. Germany ranks 18th within the World Economic Forum's Energy Transition Index – well behind other AAA rated sovereigns, all of which rank within the top five. The Council of Experts on Climate Change has noted that Germany is currently not on track to meet its emission reduction targets specified in the 2019 Federal Climate Change Act. In 2022, Germany's greenhouse gas emissions fell slightly by 1.9%, meeting the target values of the Federal Climate Protection Act.
- **Social:** Germany managed to raise labour force participation before the pandemic but mostly in favour of the lower-paid sector. Income and wealth inequality was already on the rise in Germany before the recent crises and has likely been exacerbated by the strong rise in inflation and interest rates. The country was ranked ninth, in line with its peers, in the United Nations' 2021 Human Development Index, an indicator based on life expectancy, educational achievement and income levels. Demographic pressures are rising and are more adverse compared to peers.
- **Governance**: Germany benefits from high-quality institutions and a stable political environment. Although the last election delivered a fragmented parliament, the centre-left Social Democratic Party, the Greens and the liberal Free Democratic Party quickly established a three-way coalition and have reached compromises in key policy areas. The next elections are scheduled for October 2025.

Overview of Scope's qualitative assessments for Germany's *ESG Risks*

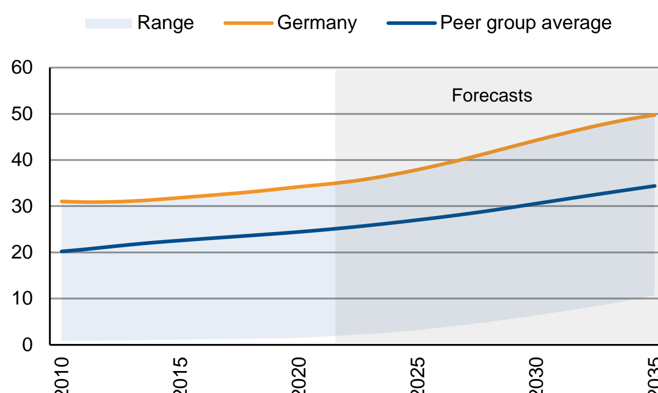
CVS indicative rating	Analytical component	Assessment	Notch adjustment	Rationale
a+	Environmental factors	Weak	-1/3	Structural challenges related to transition risk in view of carbon neutrality targets and economic importance of energy-intensive key industries
	Social factors	Neutral	0	Weak demographics in form of an ageing workforce, balanced by high social inclusion and improving labour force participation; rising inequality risks, reinforced by the Covid-19 and energy crises
	Governance factors	Neutral	0	High-quality institutions and stable political environment

Emissions per GDP and per capita, $mtCO_2e$



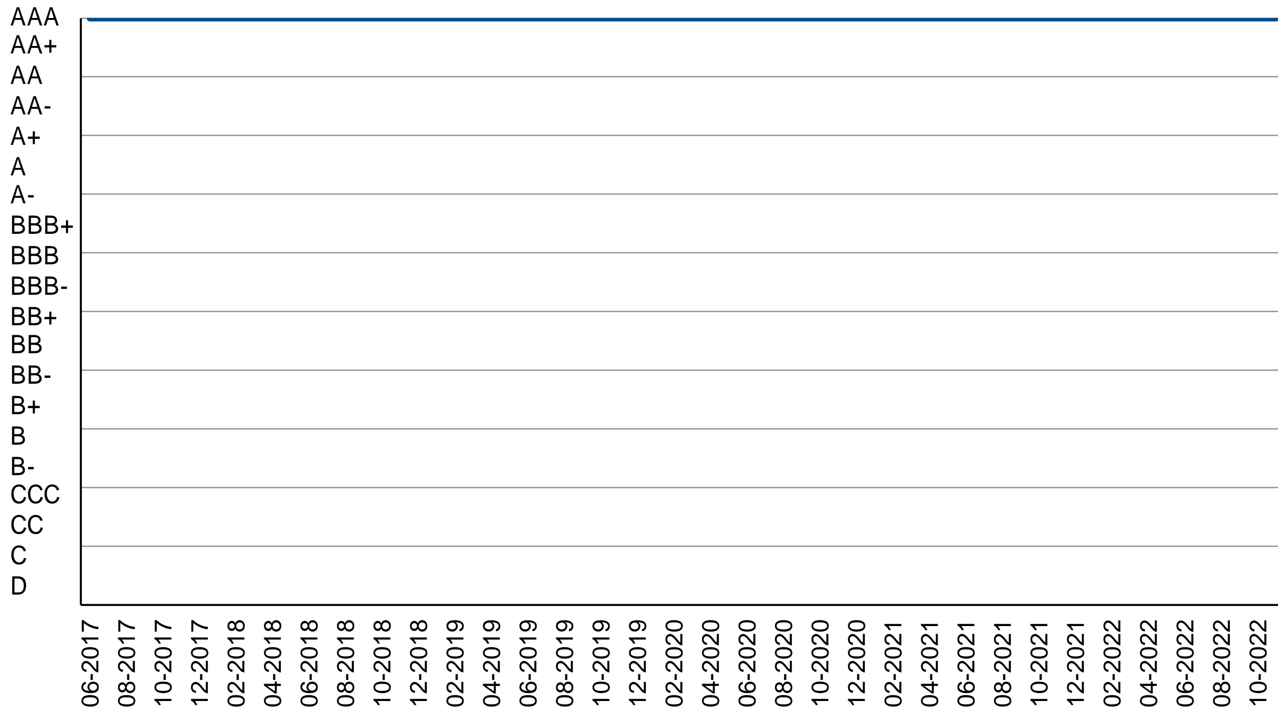
Source: European Commission, Scope Ratings

Old-age dependency ratio, %



Source: United Nations, Scope Ratings

Appendix I. Rating history



NB. Positive/Negative Outlooks are treated with a +/-0.33-notch adjustment. Credit Watch positive/negative with a +/-0.67-notch adjustment.

Appendix II. Rating peers

Rating peers are related to sovereigns with an indicative rating in the same rating category or in adjacent categories per Scope's Core Variable Scorecard, including a methodological reserve-currency adjustment.

Peer group*
Denmark
Ireland
Luxembourg
Netherlands
Norway
Sweden
Switzerland

*Publicly rated sovereigns only; the full sample may be larger.

Appendix III. Statistical table for selected CVS indicators

This table presents a selection of the indicators (24 out of 30 – with the governance indicator reflecting a composite of six indicators) used in Scope's quantitative model, the Core Variable Scorecard, in line with Scope's Sovereign Rating Methodology. The metrics and sources for the data presented here ensure comparability across global peers and may therefore differ from national and other selective international statistics.

Pillar	Core variable	Source	2018	2019	2020	2021	2022	2023
Domestic Economic	GDP per capita, USD '000s	IMF	48.0	46.8	46.7	51.2	48.6	51.4
	Nominal GDP, USD bn	IMF	3,976.2	3,888.7	3,886.6	4,262.8	4,075.4	4,308.9
	Real growth, %	IMF	1.0	1.1	-3.7	2.6	1.8	-0.1
	CPI inflation, %	IMF	1.9	1.4	0.4	3.2	8.7	6.2
	Unemployment rate, %	WB	3.4	3.1	3.9	3.6	-	-
Public Finance	Public debt, % of GDP	IMF	61.3	58.9	68.0	68.6	66.5	67.2
	Interest payment, % of revenue	IMF	1.6	1.2	1.0	0.9	1.2	1.7
	Primary balance, % of GDP	IMF	2.7	2.1	-3.9	-3.3	-2.1	-2.9
External Economic	Current account balance, % of GDP	IMF	8.0	8.2	7.1	7.7	4.2	4.7
	Total reserves, months of imports	IMF	1.3	1.6	2.0	1.9	-	-
	NIIP, % of GDP	IMF	50.7	58.7	68.6	67.1	72.0	-
Financial Stability	NPL ratio, % of total loans	IMF	1.2	1.1	-	-	-	-
	Tier 1 ratio, % of risk-weighted assets	IMF	16.5	16.6	16.1	16.8	16.5	-
	Credit to private sector, % of GDP	WB	78.2	79.6	84.8	-	-	-
ESG	CO_2 per EUR 1,000 of GDP, mtCO_2e	EC	169.9	156.6	147.1	151.3	-	-
	Income share of bottom 50%, %	WID	18.9	18.9	19.0	19.0	-	-
	Labour-force participation rate, %	WB	78.5	79.1	-	-	-	-
	Old-age dependency ratio, %	UN	33.1	33.6	34.2	34.7	35.2	36.0
	Composite governance indicators*	WB	1.5	1.4	1.4	1.4	-	-

* Average of the six World Bank Worldwide Governance Indicators

Appendix IV. Economic development and default indicators

IMF Development Classification — Advanced economy

5y USD CDS spread (bps) as of 5 May 2023 — 13.3

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