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Research Report on Germany

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Ratings

Sovereign Government Credit (LC)	AAA
Sovereign Government Credit (FC)	AAA
Country Credit Environment (LC)	AAA
Country Credit Environment (FC)	AAA

* These ratings are unsolicited

Main Economic Indicators of Germany

Macro indicators	2013	2014	2015
Gross gov. debt, EUR bn	2171	2176	2153
Nominal GDP, EUR bn	2821	2916	3026
Real GDP growth, %	0,4	1,6	1,7
Gross gov. debt/GDP, %	77,0	74,6	71,2
Deficit (surplus)/GDP, %	0,1	0,3	0,6
Inflation rate, %	1,2	0,2	0,3
Current Account Balance/GDP, %	-	-	8,2
External debt, USD bn	-	-	-

Development indicators	2015
Inequality adj. HDI	0,85
GDP per capita, USD th	47,0

Default indicator	11.04.2016
5-Year CDS spread, Bp	18,0
10Y Gov Bond Yield, %	0,14

Source: RAEX (Europe) calculations based on data from the IMF, DESTATIS, Deutsche Bank, Eurostat.

Summary

Germany's ratings at 'AAA' are driven by the country's competitive, advanced and diversified economy and its resilience to withstand external shocks. Bearable and declining levels of government debt, combined with twin surpluses were additional factors which contributed to the outstanding creditworthiness of the country.

The sound macroeconomic position of Germany is the result of the country's exposure to favorable fundamentals which helped to boost internal and external demand. The banking sector remains solid with growing credit to GDP and declining NPLs in recent years.

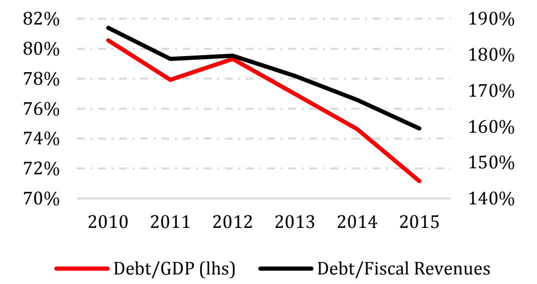
Downward debt trend. Germany's solid economic performance and sustained increase of tax revenues allowed the government to cut its debt by EUR 22,7 bn in 2015 down to EUR 2 153 bn. This translated into a reduction of 3,4p.p. and 8p.p. in the debt to GDP and debt to budget revenues ratios, standing at 71,2% and 159,5% by end-2015 respectively. With these results Germany records three consecutive years of debt metrics reduction (see graph 1).

Short-term debt followed the same trend declining by EUR 31 bn down to EUR 191 bn during the first three quarters of 2015. This figure, which remains comfortable at 6,3% of GDP and 14,1% of budget revenues, presents no significant risk for the German government. The Agency expects further strengthening of the German net credit position on the basis of encouraging economic forecasts.

Twin balances keep consolidating. Boosted by better favorable internal economic conditions as well as external fundamentals, the German fiscal balance showed a constant consolidation in all government levels over the past years. This resulted in a 0,6% surplus by end-2015 (see graph 2). The largest improvements came from the Central and State level, which together moved from a deficit of -4,1% in 2010 to a surplus of 0,4% in 2015. Such conditions provide Germany with comfortable fiscal space to manage the recently unexpected migrant crisis without significantly negative consequences.

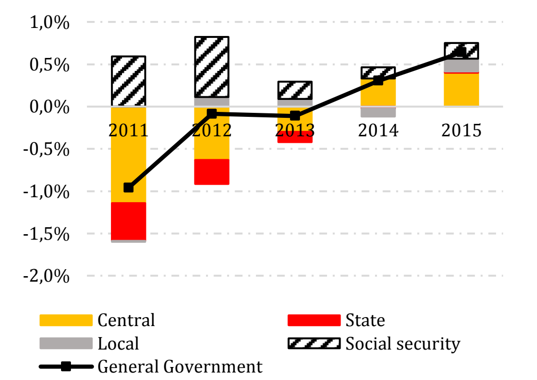
The German trade balance surplus at 8,2% in 2015 is rooted in structural and external factors. Germany's export-oriented economy drove the trade balance surplus evidenced over the past decades. However, more recently,

Graph 1: German government debt metrics



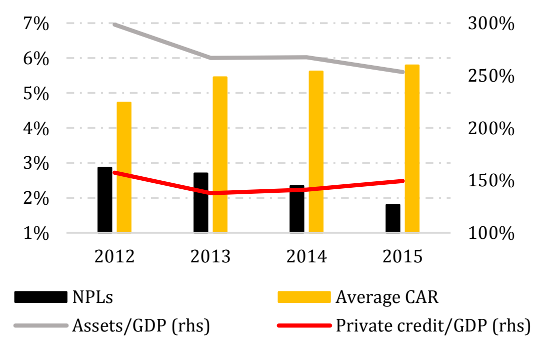
Source: RAEX (Europe) calculations based on data from the IMF, DESTATIS

Graph 2: Fiscal balance by government levels



Source: RAEX (Europe) calculations based on data from the DESTATIS

Graph 3: Main banking indicators



Source: RAEX (Europe) calculations based on data from German Bundesbank, World Bank

low world oil prices combined with good economic conditions of the largest importers of German-goods[1] contributed significantly to the trade surplus growth observed during 2014-2015 (16% Y-o-Y).

Sound macroeconomic position. The German economy has shown strong spill-over resilience to the economic slowdown in key emerging countries, the Russian-Ukrainian conflict and resumption of the Greek sovereign debt crisis in early 2015. Germany's real GDP growth rate stood above its European peers in 2015 at 1,7% and we expect it to reach a similar figure by end-2016. The country has benefited from lower world oil prices, weaker EUR that stimulates exports, as well as robust private consumption boosted by growth in real wages since 2014.

The ECB's expansionary monetary policy helped to boost the German inflation rate up to 0,3% by end-2015 from 0,17% a year before and reduced the fears of a potential deflationary process in the Euro area. Despite minimum wage being introduced in 2015, unemployment rate continued to decline, standing at 4,5% by end-2015.

Improving banking indicators. Even though Germany has a highly developed and wide-spread banking system, the sector's assets to GDP ratio showed a negative trend from 300% in 2012 to 253% in 2015. In contrast, driven by low interest rates and the increase in the inflation rate, the volume of private credit to GDP has steadily increased after reaching 138% in 2013 (see graph 3).

Banks' average capital adequacy ratio at 5,8% is still low but showed a positive trend over the past years. If such a trend remains in place, the German banking system will have enough buffers to better face potential risks. Non-performing loans (NPLs) have declined significantly driven by the country's steady economic growth. With the country's largest commercial bank (Deutsche Bank) under recovery and a low interest rate environment, profitability has been low and falling in the industry.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

http://www.raexpert.eu/reports/Press_release_Germany_15.04.2016.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.

[1] The five largest importers of German goods and services in 2015 were USA, France, UK, Netherlands and China (Source: Destatis, March 2016).