Rating-Agentur Expert RA confirmed at 'AAA' the ratings of Germany. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Germany at 'AAA' (Highest level of creditworthiness of the government) in national currency and at 'AAA' (Highest level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Even though real GDP grew at a pace slower than expected in 2H 2018, it still hiked by 1,5% y-o-y. The lower reading is a result of lower exports and issues in the automotive sector; nonetheless, domestic consumption remained solid. In the mid-term perspective we anticipate the economy to be strong but with many downside risks such as Brexit and global trade tensions. In the long-term we continue to see a declining growth due to the lack of skilled labor and aging population combined with the lack of structural reforms to solve these issues;
- Short-term debt levels remain favorable. As of 3Q 2018, short-term debt was 16% of GDP and 26% of total government debt;
- Germany remains highly supported by strong competitiveness, economic development and diversification of the economy. In 2018, we anticipate real GDP per capita in PPP terms to have been around USD 52,9 th higher than the average of its peers[1]. Additionally, Germany ranked 3rd out of 140 countries in the competitiveness index from the World Economic Forum and 24th out of 190 countries in the Doing Business ranking published by the World Bank in 2019;
- As anticipated in our previous review, inflation (HICP) stood at around 1,7% as of the end of 2018 as a result of solid consumption and investment;
- The spread between the 10Y German Bund and the US 10Y bond is negative by around 2,6p.p. Moreover, the 10Y German Bund yield stands currently at around 0,19% and has been constantly declining since the beginning of 2018 showing the investors' confidence in German government obligations and confirming its status as a "safe haven";
- The balanced fiscal budget remains a key strength and buffer for the German government. In 2018, the budget surplus widened even further to 1,7% of GDP (1% in 2017). Despite the slowdown in economic output, we do not expect the policy to turn to a more accommodative territory in our mid-term view; instead, we anticipate a well-balanced budget in line with the plan announced in 2018;
- The unemployment rate in Germany remained stable, as we previously anticipated, towards the end of 2018 and stood at 3,4%. High employment levels in the country have propelled domestic demand and, thus, have caused the inflation level to rise. Going forward, we expect this rate to remain stable as capacity utilization remains high;
- The German banking system remains quite solid with Regulatory Capital to Risk-Weighted Assets at 19,15% and low NPLs to total loans at 1,5% as of 3Q 2018. Moreover, funding

[1] Peers include Austria, Japan, UK and USA.

and liquidity metrics remain favorable. Despite profitability in the banking system remaining subdued as compared with peers, it continued to be positive with ROA at 0,4%;

- Highly developed national stock market (Deutsche Börse) with a market capitalization to GDP ratio of 45% in 2018.

Restricting factors:

- As anticipated, government obligations remain on a downward trend. We expect general government debt to have been around 59,8% of GDP and 132,6% of budget revenues as of 2018 remaining lower than peers. Even though we still anticipate debt to continue to decline as the government has no plans for additional fiscal spending, worse economic struggles than recently experienced may cause revenues to decline and force the government to provide additional stimulus. The Agency will closely observe the discussion on the budget policy for 2020-2023 set to take place in May 2019;
- Aging population and low birth rates in Germany continue to be a concern in regards to the shirking working force in the country. As mentioned in our previous review, pension and healthcare spending are projected to grow significantly. According to the 2018 Aging Report from the European Commission, age related spending is expected to increase by 4,2p.p. by 2070, well above the EU average of 1,7p.p. However, recent policy changes, such as making it easier for employers to hire foreigners, have slightly eased pressure on this topic temporarily;
- The average banks' capital to assets ratio is expected to remain subdued in 2018 at 6,3%, slightly below the average of other European peers.

Negative factors:

- Overall credit to the economy as a percentage of GDP is expected to have declined further in 2018. According to our estimate, domestic credit and bank assets to GDP are expected to be around 126% and 230% respectively, a decrease of about 1p.p. and 6p.p. accordingly. Despite the declines, household and enterprise credit have maintained a consistent annual growth pace. As of end-2018, both loan segments together grew by 4,5% y-o-y outgrowing the increase in nominal GDP;
- The concentration of state owned banks remains a negative factor as it is still substantial. As of the end of 2018, assets from *Landesbanken* and *Sparkassen* accounted for around 27,6% of the total sector. Since the size of the assets of these types of banks is quite high, so is the size of their liabilities for which the government is responsible, this creates contingent liabilities for the state. Moreover, contingent liabilities become even higher when we add government guarantees (around 14% of GDP). Despite this, in a scenario where the German government would have to intervene to cover potential liabilities, we consider the authorities to have enough buffers to absorb the shock.

Support factors:

- Germany participates and is a key member of the European Union (very strong support factor);
- The country has an extremely strong financial system which affects other countries (very strong support factor);
- The country has a strong, stable and important reserve currency (Euro) (moderately weak support factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to a downgrade:

- Continued economic downturn as a result of negative dynamics abroad which will result in deteriorating public finances.

“The ratings of Germany at ‘AAA’ reflect mainly the superb position of the government’s public finances, the extremely strong external stance as well as a resilient and solid economy. Moreover, the banking sector remains well capitalized and with a strong liquidity position, while unemployment levels remain low and stable.

However, there are some downside risks which we do not consider will threaten the country’s creditworthiness in the mid-term perspective. Factors such as, contingent liabilities from the banking system, ageing population and the global trade disputes could potentially hurt the strong position of Germany in the external sphere and create imbalances in its public finances.” – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Germany is available at:

https://raexpert.eu/reports/Research_report_Germany_01.03.2019.pdf

Next scheduled rating publication: 30 August 2019. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2019

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
07.09.2018	Scheduled revision of both types of ratings	AAA	AAA	Stable	Stable
09.03.2018	Scheduled revision of both types of ratings	AAA	AAA	NA	NA
15.09.2017	Scheduled revision of both types of ratings	AAA	AAA	NA	NA
17.03.2017	Scheduled revision of both types of ratings	AAA	AAA	NA	NA
23.09.2016	Scheduled revision of both types of ratings	AAA	AAA	NA	NA
15.04.2016	First assignment of both types of ratings for the country	AAA	AAA	NA	NA

Minute's summary

The rating committee for Germany was held on 28 February 2019. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from May 2018). Descriptions and definitions of all rating categories can be found under the Rating scale section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

The definition of default can be found on the Agency's website in the section for Internal policies.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, German Bundesbank, European Central Bank, Ministry of Finance of Germany, Deutsche Börse, Destatis, Cbonds.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's press-release and research report.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.