RAEX-Europe confirmed at ‘AAA’ the ratings of Germany. The rating outlook is stable.

RAEX-Europe 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:

- We anticipate the level of short-term debt to have increased to around 18% of overall debt and 16% of GDP as of 2Q 2020 in order to fulfil part of the financing needs resulting from the coronavirus crisis. However, it remains well covered by budget revenues;
- Germany remains one of the world's leaders in terms of real GDP per capita at PPPs, which was USD 53,6 th in 2019. Moreover, economic development remains a key strength as the country occupied the seventh position in the World Economic Forum's competitiveness index and the 22nd position in the World Bank's business ranking in 2019;
- After rising by 1,53% in 2019, the HCIP changed by 0% y-o-y as of July 2020 reflecting lower energy prices, as well as depressed consumer demand during the period resulting from the lockdown measures imposed in the country and lower overall economic activity. However, most recently, the VAT slash implemented by the government played a larger role on the flat inflation growth rate;
- The spread between 10-year German and US bonds is about -1,1p.p. German bonds continue to have a negative yield, as a result of being considered a safe haven asset amid the global pandemic;
- The fiscal policy stance shifted dramatically in order to respond to the economic ravage caused by the coronavirus situation, which we assess as a positive step from the government. After several years fixated on the so-called “black zero” policy, the federal government approved an abundant supplementary budget for an amount of about EUR 285 bn in order to implement a set of measures to weather the impact of the pandemic on the economy. At the same time, state governments have announced expenditures of about EUR 140 bn to support the local economies. We estimate that the overall expenditures will account to around 14% of GDP. Thus we expect a deficit of around 5,6% of GDP in 2020;
- After posting a record figure of 3,2% in 2019, the unemployment rate hiked to 4,5% as of June 2020 due to the impact of the coronavirus crisis. Despite the increase, the rate has remained quite stable as a consequence of the “Kurzarbeit” program, the German short-time working scheme where employers, instead of laying off employees, they only reduce their working hours and the government pays 60% of the salary. Nonetheless, we anticipate the unemployment rate to increase if the crisis were to exacerbate further;
- The fundamental metrics of the banking system keep showing certain stability. As of 1Q 2020, the NPLs ratio remains lower than 2%, the capital adequacy ratio is still quite solid at 18% and the liquid assets to total short-term liabilities ratio was solid at 152%. Even though we anticipate these metrics to somewhat deteriorate as a result of the pandemic, we still do not expect any extreme risks hitting the sector;

- The national stock markets in Germany remain highly developed with a market capitalization to GDP ratio of 54% in 2019.

Restricting factors:

- In 2019, government debt to GDP broke the 60% threshold standing at 59,5%, while debt to budget revenues declined down to 127,8%. However, as a result of the global pandemic, the level of government debt to GDP is expected to hike up to up to 75% resulting from the government's increased debt issuance of around EUR 218,5 bn in debt this year to finance COVID-related expenditures, combined with a massive shrink of nominal GDP. Nevertheless, we anticipate debt to resume a declining trend in 2021;
- The economy grew marginally in 2019 at a rate of 0,56% and, as of 2Q 2020, it dipped a record 11,7% y-o-y reflecting the immense hit of the global pandemic in the economy. As a consequence of the measures implemented to avoid further spread of the coronavirus, domestic and foreign demand both retreated harshly. The overall negative consumer and investment sentiment most likely took a toll in household consumption as well as business investments. Going forward, we expect the economy to shrink by about 7% in 2020 on a base case scenario. However, the development of the economy will largely depend on how the resurgence of COVID-19 cases are controlled as, if cases continue to increase, we anticipate further restrictive measures to be implemented, which would directly negatively affect the economy;
- Aging population and low birth rates in Germany continue to be a concern in regards to the shirking working force in the country. These dynamics are expected to have a direct impact on economic growth and public finances in the long-term as pension and healthcare spending are projected to grow significantly. Moreover, the recent approval of the basic pension increases public spending while not solving the long-term issue;
- The banking sector's total assets to GDP increased by 9p.p. y-o-y in 2019, while domestic lending to GDP increased by around 2p.p. However, as of June 2020 we have seen a decline in the level of loans as a result of lower credit demand due to the effect of the pandemic. From May to June 2020, the absolute value of loans to non-MFIs declined by 0,2%;
- The average banks' capital to assets ratio remained subdued in 2019 at around 6,5%, slightly below the average 7% for European Union.

Negative factors:

- Profitability in the German banking sector remains low resulting from high competition, low interest rates and high operating costs. Moreover, a as a result of the coronavirus crisis, we anticipate further lower profitability, as well as an increase in the level of NPLs. As mentioned in our previous review, looser conditions to extend credit will now have an adverse effect on the banks' balance sheet. However, the reduction of the countercyclical capital buffer from 0,25% to 0% provides additional room for the sector to facilitate credit growth. Furthermore, we still consider the system to be well-capitalized, as previously mentioned;
- Germany's exposure to potential contingent liabilities remains one of the highest in the EU, as the country has one of the most elevated amount of government guarantees among the 28 EU amount of as they represent about 12,8% of GDP at the end of 2018; while liabilities of public corporations were about 90,5% (mostly related to *Landesbanken* and *Sparkassen*) as of the same date[1]. Both figures remain among the top-5 countries in the EU. In the event of materialization of such liabilities, the government would have to meet obligations and endure unanticipated pressure on the budget. Despite this, the risk of these obligations transferring to the balance sheet of the government is relatively low.

Support factors:

- Germany participates and is a key member of the European Union (very strong support-

[1] According to Eurostat Report "Contingent liabilities and non-performing loans in the EU Member States in 2018".

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 an upgrade:

- Prolonged economic downturn as a result of an extended coronavirus pandemic which will result in a lingering deterioration in public finances;
- Substantial worsening in financial soundness indicators in the banking system.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; Level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None

"The confirmation of Germany's credit ratings at 'AAA' reflect mainly the vast fiscal buffers the government has to confront the pandemic and also, the ability to use these funds in an efficient way. In addition to this, Germany's economy remains solid and highly diversified, its external stance is still strong and, despite unprofitable, the banking system is liquid and has an adequate level of capitalization.

However, even though we do not consider this as a likely scenario, the fact that the development of the pandemic is hard to predict, the country is still highly exposed to further economic deterioration, which could need additional fiscal support and higher debt levels for years to come. Moreover, the banking system profitability remains quite low and the whole sector will be tested as the coronavirus crisis will most certainly lead to an increase in the level of low quality assets. Also contingent liabilities remain a latent risk of materialization. Despite all this, we do not anticipate the creditworthiness to be threatened in the mid-term view." – Clarified Hector Alvarez, Associate Director of RAEX-Europe.

Research report on Germany is available at:

https://raexpert.eu/reports/Research_report_Germany_28.08.2020.pdf

Next scheduled rating publication: TBD December 2020. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2020

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
28.02.2020	Scheduled revision of both types of ratings	AAA	AAA	Stable	Stable
30.08.2019	Scheduled revision of both types of ratings	AAA	AAA	Stable	Stable
01.03.2019	Scheduled revision of both types of ratings	AAA	AAA	Stable	Stable
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 27 August 2020. 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 April 2019). 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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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

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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.

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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.