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:

- The government's short-term debt obligations are maintained at a comfortable level and at the end of 2018 were 12% of GDP and 27% of budget revenues. In addition, comfortable debt servicing is supported by negative interest rates;
- In 2018, Germany was one of the world's leaders in real GDP per capita at PPPs, which rose to USD 52,9 th. The high level of economic development is proved by the occupying the 3rd position in the World Economic Forum's Competitiveness Index and the 24th position in the World Bank's business ranking in 2018;
- Although the inflation was volatile in the 1H 2019 as HCIP fluctuated between 2,1% in April 2019, fostered by energy and food prices, and 1,14% in July 2019, we anticipate inflation growth will stay below the 2% upper target of the ECB's price stability policy;
- The spread between 10-year German and US bonds is about -2,3 p.p.. Since the beginning of 2019, long-term German bonds have a negative yield, which is gradually declining and has reached record levels. This trend reflects the heightened investors' expectations for the ECB's easing of monetary actions in the near term;
- The conservative fiscal policy over the last five years has contributed to an annual increase in the budget surplus, which has reached 1,7% in 2018. Current government's plans to stimulate the economy include a transition to a moderately expansionary fiscal policy, which includes an increase in social spending and a reduction in the tax burden on the population. Nevertheless, given the accumulated reserves of previous periods, the fiscal balance expected to remain positive at 1% of GDP in 2019;
- Despite the current slowdown in the economy, demand for labor remains high, reaching a historically low unemployment rate of 3,4% by the end of 2018. In the medium term, demand for employees will be stimulated by the gap from ageing of the current working population;
- In general, the banking system is stable, with favorable liquidity and funding metrics. Non-performing loans are at 1,6% as of 3Q 2018, which indicates a qualitative and conservative risk management. Tier I capital to risk-weighted assets ratio stood at 16,6% compared to 16,1% in the EU and the ratio of Liquid assets to total short-term liabilities was robust at 152% as of the end 2018;
- Highly developed national stock market (Deutsche Börse) with a market capitalization to GDP ratio of 45% in 2018.

Restricting factors:

- Compared to a 1,4% growth in 2018, the economy stagnated in the 1H 2019 amid a shrinking foreign trade activity, reflecting weak external demand for products in the manufacturing sector. In 2Q 2019, real GDP growth was 0,4% y-o-y however fell by 0,1% q-o-q. Despite this, we expect the year-end growth to be around 0,7%, supported by strong household consumption and government spending. In the medium term, the general slowdown in the Eurozone, the threat of trade tariff sanctions from the U.S. and the Brexit effect continue to be constraining factors;

- The long-term gradual reduction of the government's debt owing to economic growth, low interest rates and fiscal consolidation has led to a debt-to-GDP ratio of 60,9% in 2018 that is slightly above the 60% threshold recommended by the European Union authorities. We anticipate that in the ongoing macroeconomic environment, debt levels will continue to decline gradually. Even in case of macro-fiscal shocks, the stress scenarios developed by the IMF indicate that the debt burdens will not exceed the current value;
- Population ageing in Germany will continue to increase despite high immigration and working force expected to decrease by 10% by 2035. Critical demographic situation with ageing population and low birth rate in the long run will create pressure on the finances and economy of the country through a significant reduction in labor supply and increase in social spending;
- The ratio of domestic loans to GDP continued long downward run, reaching 126% in 2018, compared to 165% at its peak in 2010, although a positive recovery can be observed, especially in non-financial corporations' lending and mortgages. Active development is hampered by the high leverage of large banks (G-SIBs) and government regional banks, while medium-sized and small banks are trying to consolidate and refocus on fee-based operations owing to the low interest rate environment;
- The average banks' capital to assets ratio remained subdued in 2018 at 6,7%, slightly below the average 7% for European Union.

Negative factors:

- One of the key structural challenges for the banking system is a low profitability caused by prolonged low interest rates' environment but, mostly, by excessive operational costs. Although the banking system had a positive average ROA at 0,2% in 2018, strong dependence on interest income makes banks more vulnerable. Moreover, the banks have less space to generate capital organically and small German banks might face the challenge of meeting growing capital requirements during the full adoption of Basel III;
- Germany's exposure to potential contingent liabilities is one of the highest in EU, as the country ranks third among the 28 EU countries in terms of government guarantees as they represent about 11% of GDP in 2018. Moreover, liabilities of public corporations were about 90% of GDP in 2017[1]. In the event of materialization of such liabilities, especially related to the financial system in which the share of SOBs (mainly *Landesbanken* and *Sparkassen) was around* 26% of total assets in 2018, the government would have to meet obligations and endure unanticipated pressure on the budget.

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).

[1] According to Eurostat Report "Contingent liabilities and non-performing loans in the EU Member States in 2017".

SENSITIVITY ASSESSMENT:

The following developments could lead to a downgrade:

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

"The current confirmation of Germany's rating at 'AAA' with a stable outlook reflects a sustainable growth path of a highly diversified economy underpinned by the country's democratic and efficient institutions and deep integration into global value chains, which has contributed to a record low inflation, significant improvement in the external position along with an outstanding fiscal position and contracting public debt. Despite the low profitability of the banking sector, the country's financial system is reliable and one of the most developed in the world.

In the medium term, we believe the economy will be negatively affected by deteriorating global demand and trade conditions. Despite this, in our opinion, the government has more than enough fiscal buffers to partially mitigate these adverse conditions. Moreover, the country's creditworthiness will be under pressure from demographic and social factors in the long run without forcing a series of structural changes."– Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Germany is available at:

https://raexpert.eu/reports/Research_report_Germany_30.08.2019.pdf

Next scheduled rating publication: TBD in December 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
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 30 August 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 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.

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.