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Responsible Expert:

Gustavo Angel
Rating Associate

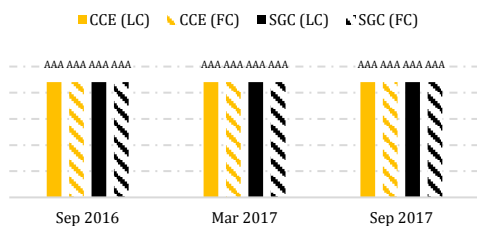**For further information contact:**
Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
         www.raexpert.eu

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

Ratings dynamics

■ CCE (LC)   ↘ CCE (FC)   ■ SGC (LC)   ↘ SGC (FC)

AAA AAA AAA AAA   AAA AAA AAA AAA   AAA AAA AAA AAA

| Sep 2016 | Mar 2017 | Sep 2017 |

Main Economic Indicators of Germany

Macro indicators	2014	2015	2016
Gross gov. debt, EUR bn	2189	2158	2119
Nominal GDP, EUR bn	2924	3033	3133
Real GDP growth, %	1,6	1,5	1,8
Gross gov. debt/GDP, %	74,9	71,2	67,6
Deficit (surplus)/GDP, %	0,3	0,7	0,8
Inflation rate, %	0,0	0,2	1,7
Current Account Balance/GDP, %	-	-	8,3
External debt, USD bn	-	-	-

Development indicators	2015
Inequality adj. HDI	0,86
GDP per capita, USD th	48,2

Default indicator	15.09.2017
5-Year CDS spread, Bp	12.5
10Y Gov Bond Yield, %	0,43

Source: RAEX (Europe) calculations based on data from IMF, WB, UN, Eurostat, Destatis, ECB

Summary

The ratings of Germany at 'AAA' remain underpinned by encouraging economic conditions, persistent twin surpluses, resilience to external shocks and a strong banking system.

Government debt load continued its downward path during 2016, reaching EUR 2,1 tn by the end of the year. This, combined with an increase in GDP and budget revenues, drove a decline in debt metrics for the fourth year in a row.

Twin surpluses remain supported by the country's strong external position and the government's successful efforts towards fiscal consolidation on the back of its reduced need for financing.

Even though political risks dissipated following the strong support of Merkel as the next German Chancellor, it is still unclear how the new Bundestag structure will impact the re-shaping of current laws and regulations.

Solid external position. Germany keeps showing strong positive results in terms of foreign trade. However, as predicted in our previous research report[1], the trade balance shrank by almost 1p.p. to 7,8% of GDP in 2016 mainly driven by higher energy prices. In spite of these risks, the Agency considers that the external position of Germany will prevail in 2017 as a result of the country's highly competitive export sector.

Declining debt metrics. The German gross government debt declined slightly by around EUR 38 bn to EUR 2,1 tn in 2016. This, combined with an increase in nominal GDP and fiscal revenues by 3,2% and 4,1% respectively, drove the overall decline of the debt metrics (see graph 1).

The decline in government debt was mainly due to consistent primary surpluses at a general government level. Such surpluses resulted from robust economic growth and low interest rates, which raised tax revenues and also reduced interest expenses respectively.
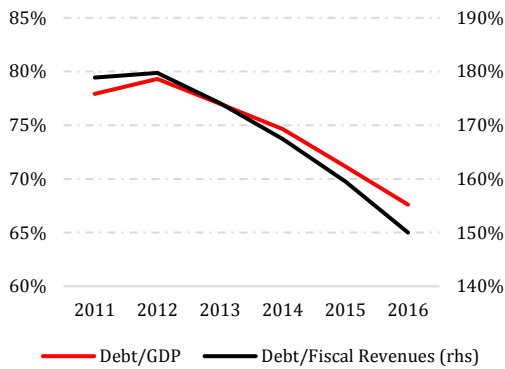
Short-term debt (including debt due in less than a year) at around 15% of GDP and 33% of budget revenues present no significant risk for the economy. Furthermore, the reduced long-term risks are evidenced by the

[1] Research report on Germany from 17 March 2017 (https://raexpert.eu/reports/Research_report_Germany_17.03.2017.pdf).
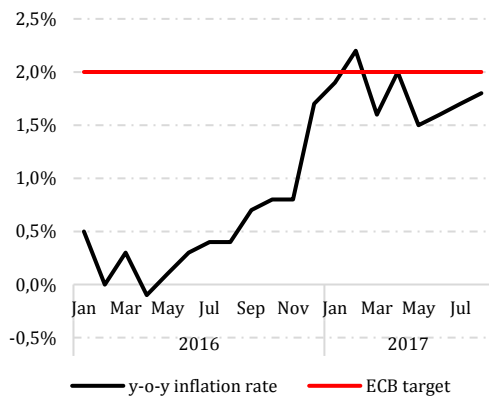
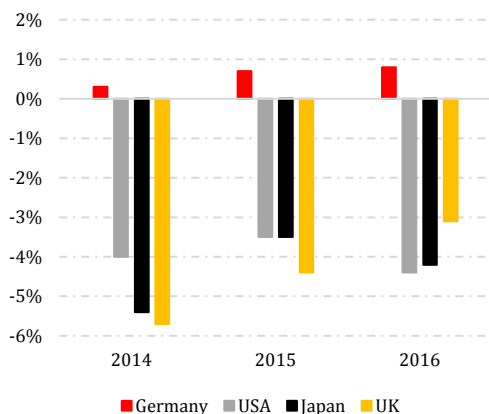**Graph 1:** Government debt metrics, %

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

Graph 2: Inflation rate in Germany, %

Source: RAEX (Europe) calculations based on data from Destatis and ECB

Graph 3: Fiscal balance, % GDP

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

low and declining yield on the 10Y government bond at around 0,4% as of September 2017.

Strong macro stance. In 2016, Germany kept benefiting from an outstanding macroeconomic position as evidenced by a low unemployment rate at 4,2%, a stable inflation rate at 1,7% (below the 2% mandate of the ECB) and a strong and increasing real GDP growth rate at 1,8% (see graph 2).

Despite the German inflation rate showing a sustained level around the ECB's target through August 2017, the ECB decided in September to keep rates low and its monetary policy unchanged until the Governing Council sees a sustained adjustment in the path of price dynamics consistent with its inflation aim in the entire Eurozone.

Ongoing fiscal consolidation. Compared to its international peers, Germany has an outstanding fiscal position as the country's surplus stood at 0,4% of GDP in 2016 (see graph 3). This was the result of a long-term fiscal consolidation plan which started in 2010, when the fiscal deficit reached a record 4,2% of GDP, and propelled the increase of fiscal revenues while containing expenditure.

Going forward, the fiscal stance looks set to remain comfortable, at least in the short to medium term, as fiscal revenues continue to grow at a strong pace. However, the long-term trend of the fiscal metrics will depend on the political decisions arising from the newly formed parliament after the September Federal elections.

Even though political risks have been mitigated recently in Germany, the country is still facing fiscal risks as elections planned for 2017 at a Federal and State levels are likely to change the country's political landscape. Currently, polls results are showing that the two main parties (CDU and SPD) have the strongest support from the population. SPD leaders have already unveiled that the party's policies will be aimed at increasing spending for social benefits and education which will likely have a negative impact on public finances.
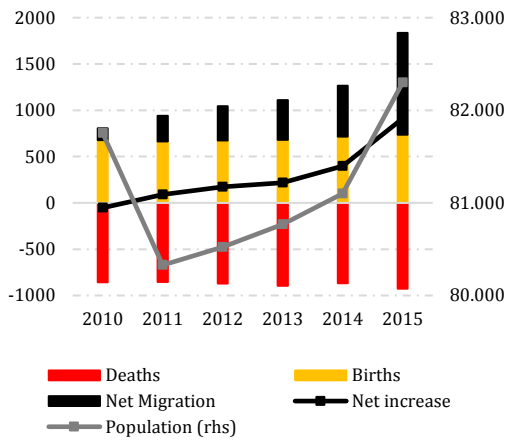
Even though polls are showing that the support for the Eurosceptic party 'Alternative fuer Deutschland' (AfD) is falling, the party will likely reach a number of seats in the Bundestag (legislative branch) for the first time in history. In our view, this would make the composition of the Bundestag more heterogeneous and would be challenging for the ruling party to build a coalition.

Resilient banking sector with downside risks. The German banking sector remains strong with assets at 251% of GDP as of December 2016.

The overall increase in private credit, which in part was the combined result of low interest rates and loose bank lending standards, has accelerated the housing price growth rate. However, private credit to GDP remained almost flat since 2015 around 134% driven by the sustained and strong increase of real GDP.

While still low, non-performing loans to total loans ratio increased by 0,5p.p. to 2,5% in 2016. Even though this figure does not introduce risks in the short run, a prolonged increase of this metric could cause a decline in banks' profits and assets in the long term. We expect, however, that the sustained economic growth in Germany will mitigate such a risk.

Population trends likely to rebound. German population showed a negative trend until 2011, but has rebounded since then thanks to a net increase in the number of immigrants (see graph 4). In 2015, there was a record increase of population driven by a substantial inflow of refugees which temporarily mitigated the shortage of workers in the labor market.

If the positive immigration trend continues and government initiatives to increase female participation in the labor market succeed, Germany would largely mitigate long-term risks in the pension and health care systems.

Graph 4: Drivers of population dynamics, th

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

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_15.09.2017.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.