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Fitch Affirms Germany at 'AAA'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 28 Feb 2025: Fitch Ratings has affirmed Germany's Long-Term Foreign-Currency Issuer Default Rating (IDR) at 'AAA' with a Stable Outlook.

A full list of rating actions is at the end of this rating action commentary.

Key Rating Drivers

Strong Fundamentals Amid Structural Challenges: Germany's 'AAA' rating is underpinned by its high per capita income, large and diversified economy, strong institutional framework, high current account surpluses and positive net international investment position. The rating is further supported by a longstanding commitment to fiscal conservatism and its status as the benchmark issuer in the eurozone, providing it with large financing flexibility and exceptionally low government financing costs. Despite these strengths, Germany faces several structural challenges, which weigh on its growth prospects.

Stagnating Economy: Germany's post-pandemic economic performance remains weak, reflecting a combination of external shocks and structural factors. The economy contracted by 0.2% in real terms in 2024, making output slightly lower than 4Q19. We project modest growth of just 0.3% in 2025, as economic uncertainty surrounding the federal election and potential US tariffs additionally weigh on economic sentiment. We expect growth to pick up to 1% in 2026 as some of these uncertainties reduce and as the new government is likely to implement measures to support growth, including lower energy prices and increased investments.

Structural Headwinds: Germany faces significant structural challenges impacting its economy. Rising competition from China is eroding Germany's export share. Its export-oriented nature of the economy and high export share to the US exposes Germany to tariff risk and potential investment reallocation to the US. The manufacturing sector is struggling with a competitiveness loss due to increased energy and labour costs, as well as bureaucratic hurdles and high corporate taxes.

Lower Potential Growth: To reflect these structural pressures, we have revised our potential growth estimate to 0.6% over 2024-2028, down from 1.1% over 2019-2027. The revision is driven by slower growth in the working-age population and weaker investment. It also incorporates our view that the shock caused by higher gas prices has taken a bigger toll on the German economy than we expected, reflected particularly in the country's capacity in energy-intensive industries going unused.

Coalition Negotiations to Be Complex: The recent German election has paved the way for a two-party government coalition between the Christian Democratic Union/Christian Social Union (centre-right) and the Social Democratic Party (centre-left). However, we anticipate that coalition negotiations will be complex due to substantial policy disparities between the two parties, particularly in areas such as taxation, welfare, investments, and financing. Furthermore, the fringe parties (AfD and The Left) now have a blocking minority for constitutional reforms. In our view, there is a clear trend of increasing political fragmentation and polarisation, which is likely to continue if the next government fails to address Germany's mounting economic and social challenges.

Moderate Fiscal Deficits: Germany's fiscal deficit was 2.6% of GDP in 2024, below the eurozone's deficit of 3.2% but wider than our 1.7% projection at our last review, mostly reflecting a weaker growth outlook. We assume some fiscal loosening post-election, as the shifting geopolitical environment increases pressure on defence spending and the economic stagnation is pressuring parties to increase investments and lower input costs for companies that struggle with a loss of competitiveness. Under our baseline scenario, we expect the fiscal deficits to widen to 2.8% in 2025 and 3% of GDP in 2026 but not exceed the EU's 3% Maastricht threshold.

Government Debt-to-GDP No Longer Declining: Larger fiscal deficits and moderate nominal economic growth means we expect Germany's general government debt to increase in the medium term (to 65.8% of GDP in 2026 from 63.8% of GDP estimated in 2024), shifting from a previously declining path. We assume the debt trajectory will be aided by favourable stock-flow adjustments from repayment of government-guaranteed coronavirus and energy shock assistance loans, as well as unwinding Germany's bad banks and expected privatisation of Uniper (an energy company nationalised in 2022). The debt ratio compares favourably with the eurozone average of 91.2% of GDP but is significantly above the 'AAA' rated median of 36.5% of GDP and the highest among 'AAA' rated sovereigns.

In the long term, Germany faces spending pressures from defence commitments, the energy transition and an aging population. The Armed Forces Fund (EUR100 billion or 2.5% of GDP) helped lift Germany's military spending to 2% of GDP but rising geopolitical tensions will require additional budget allocations.

Low Financing Costs: Germany continues to benefit from very low financing costs, driven by strong demand for its debt, a reflection of its status as the benchmark issuer within the eurozone. This demand is bolstered by Germany's still robust credit fundamentals, prudent fiscal management as well as its record of significant debt reduction of over 20% of GDP in the decade preceding the pandemic. Germany's financing flexibility is also enhanced by its deep and liquid capital markets and large domestic savings. Interest payments as a share of GDP will rise to 1.2% by 2026 from 1% in 2024, above the 'AAA' median at 0.8% because of Germany's higher debt levels but below the eurozone median at 1.6%.

External Sector Strengths: Germany's external finances remain a key rating strength. We project the current account surplus to average 5.7% of GDP in 2025-2026, much below its 10-year average of 7.2% of GDP but significantly above the eurozone average at 3.2% of GDP. This surplus supports Germany's net international investment position (above 70% of GDP), reflecting the accumulation of foreign assets and providing a buffer against external shocks.

Sound Banking Sector: The German banking sector's 'a' Banking System Indicator shows improving profitability and sound funding and liquidity, with strong capitalisation and substantial regulatory buffers. However, we anticipate that Germany's weak economic performance will impact banks' solid asset quality. The average impaired loans ratio will come close to 2.2% at end-2025, which is still a moderate level, albeit up from 1.2% in the previous year. Fitch believes the domestic commercial real estate sector remains under pressure, despite signs of stabilisation, and further credit losses are likely.

ESG - Governance: Germany has an ESG Relevance Score (RS) of '5[+]' for both Political Stability and Rights and for the Rule of Law, Institutional and Regulatory Quality and Control of Corruption. These scores reflect the high weight that the World Bank Governance Indicators (WBGI) have in our proprietary Sovereign Rating Model (SRM). Germany has a high WBGI ranking at 87.6, reflecting its long record of stable and peaceful political transitions, well-established rights for participation in the political process, strong institutional capacity, effective rule of law and a low level of corruption.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

-- **Public Finances:** A sizeable increase in general government debt over the medium term, for example, due to a prolonged period of wider budget deficits or weak growth.

-- **Structural:** Prolonged weak economic growth, for example, due to structural economic challenges and lack of progress on structural reforms.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

-- The ratings are at the highest level on Fitch's scale and cannot be upgraded.

Sovereign Rating Model (SRM) and Qualitative Overlay (QO)

Fitch's proprietary SRM assigns Germany a score equivalent to a rating of 'AA+' on the Long-Term Foreign-Currency (LT FC) IDR scale.

In accordance with its rating criteria, Fitch's sovereign rating committee decided not to adopt the score indicated by the SRM as the starting point for its analysis because the SRM output has migrated to 'AA+', but in our view this is potentially a temporary or unsustainable deterioration. Consequently, the committee decided to adopt 'AAA' as the starting point for its analysis, unchanged from the prior committee.

Fitch's sovereign rating committee did not adjust the output from the SRM to arrive at the final LT FC IDR.

Fitch's SRM is the agency's proprietary multiple regression rating model that employs 18 variables based on three-year centred averages, including one year of forecasts, to produce a score equivalent to a LT FC IDR. Fitch's QO is a forward-looking qualitative framework designed to allow for adjustment to the SRM output to assign the final rating, reflecting factors within our criteria that are not fully quantifiable and/or not fully reflected in the SRM.

Country Ceiling

The Country Ceiling for Germany is 'AAA', in line with the LT FC IDR at the upper limit of the rating scale. We view the risk of exchange and capital controls as negligible. Fitch's Country Ceiling Model produced a starting point uplift of +3 notches and Fitch's rating committee did not apply a qualitative adjustment to the model's result.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

Germany has an ESG Relevance Score of '5[+]' for Political Stability and Rights as WBGI have the highest weight in Fitch's SRM and are, therefore, highly relevant to the rating and a key rating driver with a high weight. As Germany has a percentile rank above 50 for the respective governance indicator, this has a positive impact on the credit profile.

Germany has an ESG Relevance Score of '5[+]' for Rule of Law, Institutional & Regulatory Quality and Control of Corruption as WBGI have the highest weight in Fitch's SRM and are, therefore, highly relevant to the rating and are a key rating driver with a high weight. As Germany has a percentile rank above 50 for the respective governance indicators, this has a positive impact on the credit profile.

Germany has an ESG Relevance Score of '4[+]' for Human Rights and Political Freedoms as the Voice and Accountability pillar of the WBGI is relevant to the rating and a rating driver. As Germany has a percentile rank above 50 for the respective governance indicator, this has a positive impact on the credit profile.

Germany has an ESG Relevance Score of '4[+]' for Creditor Rights as willingness to service and repay debt is relevant to the rating and is a rating driver for Germany, as for all sovereigns. As Germany has a record of 20+ years without a restructuring of public debt, which is captured in our SRM variable, this has a positive impact on the credit profile.

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Fitch Ratings Analysts

Malgorzata Wegner

Director
Primary Rating Analyst
+49 69 768076 279
Fitch Ratings – a branch of Fitch Ratings Ireland Limited Neue Mainzer Strasse 46 - 50 Frankfurt am Main D-60311

Hannah Dimpker
Director
Secondary Rating Analyst
+49 69 768076 263

James Longsdon
Managing Director - Head of Sovereigns
Committee Chairperson
+44 20 3530 1076

Media Contacts

Peter Fitzpatrick
London
+44 20 3530 1103
peter.fitzpatrick@thefitchgroup.com

Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Germany	LT IDR	AAA	Affirmed		AAA
	ST IDR	F1+	Affirmed		F1+
	LC LT IDR	AAA	Affirmed		AAA
	LC ST IDR	F1+	Affirmed		F1+
	Country Ceiling	AAA	Affirmed		AAA
• Senior Unsecured-	LT	AAA	Affirmed		AAA

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Local currency					
• Senior Unsecured-Local currency	ST	F1+	Affirmed		F1+

RATINGS KEY	OUTLOOK	WATCH
POSITIVE		
NEGATIVE		
EVOLVING		
STABLE		

Applicable Criteria

Country Ceiling Criteria (pub.24 Jul 2023)

Sovereign Rating Criteria (pub.24 Oct 2024) (including rating assumption sensitivity)

Applicable Models

Numbers in parentheses accompanying applicable model(s) contain hyperlinks to criteria providing description of model(s).

Country Ceiling Model, v2.0.3 (1)

Debt Dynamics Model, v1.3.2 (1)

Macro-Prudential Indicator Model, v1.5.0 (1)

Sovereign Rating Model, v3.14.2 (1)

Additional Disclosures

Solicitation Status

Endorsement Status

Germany	EU Issued, UK Endorsed

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The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Fitch also provides information on best-case rating upgrade scenarios and worst-case rating downgrade scenarios (defined as the 99th percentile of rating transitions, measured in each direction) for international credit ratings, based on historical performance. A simple average across asset classes presents best-case upgrades of 4 notches and worst-case downgrades of 8 notches at the 99th percentile. For more details on sector-specific best- and worst-case scenario credit ratings, please see Best- and Worst-Case Measures under the Rating Performance page on Fitch's website.

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