CareEdge Global assigns Long Term Foreign Currency Rating of AAA (Unsolicited) to Republic of Germany

Credit Profile

Germany's robust outlook is characterised by its large, wealthy economy, solid institutions, strong external position and history of fiscal prudence. Additionally, Germany benefits from having a reserve currency. German sovereign bonds are considered as benchmark safe assets in Eurozone. Despite these credit positives, Germany has been facing cyclical challenges like slowing global economy and structural weakness like ageing population, low public investment and energy transition risks given the carbon emissions targets.

Germany has been significantly lagging behind its peers in terms of economic growth in recent past. Fiscal Austerity could further weigh on growth conditions. Continued worsening of economic growth should be closely monitored.

Strengths

- Large economic size
- High GDP per capita
- Moderate government debt and low borrowing costs
- Strong institutions

Weaknesses

- Sluggish economic growth, lagging behind its peers
- Ageing population
- Weak public investments

Key Monitorables

- Ability to meet its carbon neutrality targets given the large size of its industry.
- Ability to propel growth amidst structural challenges

Key Rating Drivers

Economic Structure & Resilience

Germany is Europe's largest economy with Nominal GDP of USD 4.4 trillion and has high GDP per capita of USD 53638 (constant PPP) in 2023. German economy gathers strength from being a large global export and manufacturing powerhouse, having high national savings and low structural unemployment. Despite these strengths; supply chain disruptions, skilled labour shortages, higher input costs, weakening global demand has impacted Germany, the only advanced economy to contract in 2023. Growth is forecasted to be 0.2% in 2024, slower than the expected advanced economies average of 1.4%.

Germany's goal to achieve carbon neutrality by 2045 necessitates technological transformation and infrastructure investment. This could be an uphill task considering a sizeable share of industry (29% of GDP). On 15 November 2023, ruling was passed by Germany's highest court against the transfer of unused EUR 60 billion in the Covid-19 pandemic related fund to climate fund. This has created a gap in the budget which could lead to more than required cuts in spending, dragging the growth further. Though for Germany, the natural gas prices have been steadily falling for past year, the current prices continue to be higher than the pre-Russian-Ukraine war, thus putting cost pressures on energy intensive industries. Furthermore, low levels of public investment (Germany 2.6% of GDP vis-à-vis OECD average of 4% of GDP) and ageing population are headwinds for economic growth.

Fiscal Strength

The General Government Debt to GDP ratio is relatively lower at 63.6% as compared to the advanced economies average of 112% in 2023. Germany has displayed strong track record of fiscal prudence post the introduction of debt-brake law in 2009, which limits federal deficits at 0.35% of GDP. German bonds are considered benchmark risk free assets in Eurozone, thus keeping the borrowing costs low. The debt brake law was suspended from 2020-2023 in the wake of Covid-19 pandemic and energy crisis. This fiscal deficit came in at 2.4% of GDP in 2023. The debt brake has been reinstated in 2024, limiting government's spending abilities. Despite this, fiscal deficit is expected to be above 1.5% of GDP in 2024 and moderate to below 1% between 2025 and 2027. High aged population has kept the social security and health bill high for the government leaving little room for public investments. Germany has also committed to increase its military expenditure to 2% of GDP from 1.6% in 2023, which could add on to its spending bill.

External Position & Linkages

Germany has a strong external position with current account surplus averaging at 7% of GDP for past 5 years (2019-23) and a large positive net international investment position (NIIP) at 70% of GDP in 2023. It also benefits from having a reserve currency. Slowing global economy and Germany's reliance on China as the most important trading partner has led to sluggish exports growth in 2023. Moreover, the automotive sector, which accounts for 17% of total exports, has been particularly hit because of disruptive technology and semiconductor shortages. The FDI flows have also significantly slowed down (0.4% of GDP in 2023 vis-à-vis 2.4% of GDP in 2021) amid economic uncertainty. Despite these challenges, the current account surplus is expected to average around 6.6% for the next 5 years, implying strong export competitiveness.

Monetary & Financial Stability

Average HICP inflation has subsided to 6% in 2023 from a multi-year high of 11% in October 2022, albeit higher than the central bank's target of 2%. Average HICP inflation is expected to further moderate to 2.4% in 2024. Core-inflation has been stickier on account of higher wage growth and services inflation. To boost the sluggish growth, there are expectations of one more rate cut in December post the June and September rate cuts. The banking sector continues to be resilient and well capitalized, however, going forward, could face risks emancipating from deterioration in asset quality amidst slowing economy.

Institutions & Quality of Governance

Germany's institutional framework and quality of governance remains strong displaying high standards and independent functioning. However, high bureaucracy and low digitization continue to be problem areas for the German economy. Germany's coalition government the centre-left between Social Democratic Party, the Greens and the liberal Free Democratic Party are facing challenges in terms of a budget crisis, farmer rally and rising popularity of far-right Alternative for Germany (AfD). Germany being the leader in Europe, remains more exposed to the geo-political risks in the region. Moreover, deteriorating relations with China remain a concern.

Germany – Select Indicators									
	Unit	2018	2019	2020	2021	2022	2023	2024 F	2025 F
Economic Indicators									
Nominal GDP	USD Billion	3,976	3,890	3,885	4,281	4,086	4,457	4,591	4,772
GDP Per Capita (Constant-PPP)	USD	53,737	54,190	52,072	53,700	54,276	53,638	53,700	54,418
Real GDP Growth	%	1.0	1.1	-3.8	3.2	1.8	-0.2	0.1	1.3
GFCF/ GDP	%	21.1	21.3	21.5	21.3	22.1	21.9	-	-
Gross Domestic Savings/ GDP	%	28.0	27.8	27.8	28.6	27.0	27.7	-	-
Exports (G&S)/GDP	%	47.3	47.1	43.5	47.3	50.9	47.1	-	-
Working-Age (15-64) Population (% Share in Total)	%	65.0	64.6	64.3	64.0	63.6	63.3	62.8	62.3
Old-Age (65+) Population (% Share in Total)	%	21.5	21.7	22.0	22.2	22.4	22.7	23.2	23.6
Fiscal Indicators – General Government									
Fiscal Balance/ GDP	%	1.9	1.5	-4.3	-3.6	-2.5	-2.4	-1.7	-1.3
Revenue/ GDP	%	46.3	46.5	46.1	47.4	47.0	46.2	46.3	46.8
Expenditure/ GDP	%	44.3	45.0	50.5	50.9	49.5	48.6	48	48.1
GG Gross Debt/ GDP	%	61.9	59.6	68.8	69.0	66.1	63.6	63.8	62.4
GG External Debt (by Creditor)/ GG Gross Debt	%	51.7	53.8	52.2	46.0	38.3	43.7	-	-
Interest/ Revenue	%	2.0	1.7	1.4	1.2	1.5	1.9	-	-
External Indicators									
Current Account Balance/ GDP	%	8.0	8.2	7.1	7.7	4.4	6.3	6.3	6.3
FDI, Net Inflows/ GDP	%	4.2	1.9	4.6	2.4	1.5	0.4	-	-
Outstanding FII Liabilities/ GDP	%	80.5	89.8	102.7	89.0	74.1	79.8	-	-
NIIP/ GDP	%	52.3	58.5	64	68.3	69.5	70.1	-	-
Foreign Exchange Reserves	USD Billion	198.2	223.8	268.8	296.0	294.7	322.9	-	-
Import Cover	Months	1.5	1.7	2.2	2.0	1.8	2.0	-	-
External Debt/GDP	%	143.1	147.9	176.9	163.4	158.4	148	-	-
Monetary and Financial Indicators									
HICP Inflation	%	1.9	1.4	0.4	3.2	8.7	6.0	2.4	2.0
Exchange Rate (Average)	LC per USD	0.85	0.89	0.88	0.85	0.95	0.93	-	-
Non-Performing Loans/ Total Gross Loans	%	1.2	1.1	1.7	1.5	1.2	1.5	-	-
Private debt, loans and debt securities/ GDP	%	120.2	122.2	130.7	130.4	127.9	-	-	-

Sources: International Monetary Fund, World Bank, Bank for International Settlements, National Sources, CareEdge Global

Note: F - Forecast; PPP – Purchasing Power Parity; GFCF – Gross Fixed Capital Formation; Exports (G&S) – Exports of Goods and Services; GG – General Government; FDI – Foreign Direct Investment; FII – Foreign Institutional Investment; NIIP – Net International Investment Position; Data refers to fiscal/calendar year and actual/estimate as reported by the source; Where general government data is unavailable, central government data is used; Latest available data for 2023

Rating History

Instrument	Type	Rating	Date
Issuer Rating	Long Term Foreign Currency (Unsolicited)	AAA	October 3, 2024

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Criteria Applied

CareEdge Sovereign Rating Methodology

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