Morningstar DBRS Confirms Federal Republic of Germany at AAA, Stable Trend

SOVEREIGNS

DBRS Ratings GmbH (Morningstar DBRS) confirmed the Federal Republic of Germany's (Germany) Long-Term Foreign and Local Currency - Issuer Ratings at AAA. At the same time, Morningstar DBRS confirmed Germany's Short-Term Foreign and Local Currency - Issuer Ratings at R-1 (high). The trend on all ratings is Stable.

KEY CREDIT RATING CONSIDERATIONS

The Stable trend reflects Morningstar DBRS' view that Germany's credit fundamentals remain very strong notwithstanding a projected widening of fiscal deficits over the next few years. Germany's fiscal outlook has been changed markedly by the loosening of the constitutional debt brake in March 2025, which enables a marked step-up in public spending particularly on defence and infrastructure in coming years. Taking into account the latter, the IMF forecasts the general government budget deficit to hover around 4% of GDP over the next five years, up from projected deficit of 2.2% in 2025. As a result, the public debt-to-GDP ratio is forecast to rise above 70% by 2029 from 62.4% in June 2025. Nevertheless, Morningstar DBRS takes the view that the government's debt affordability will remain very high over the medium-term, underpinned by a still moderate stock of public debt, a low, albeit rising, interest burden, and the country's status as a safe haven. Over the longer-term, however, reversing the upward trend in the debt trajectory is likely to require significant policy effort both with regard to fiscal consolidation and measures for strengthening the economy's low growth potential.

Germany's AAA ratings are supported by its highly developed economy and high institutional quality. Furthermore, external finances are strong and resilient to potential shocks. However, the economy faces large challenges such as population ageing and structural changes within important manufacturing industries. Furthermore, contingent liabilities, emanating from state guarantees for domestic companies and fiscal burden sharing within the currency union could eventually weigh on public finances.

CREDIT RATING DRIVERS

Morningstar DBRS could downgrade the credit ratings if public debt metrics deteriorate markedly on the back of weak economic growth and persistently large fiscal deficits. Moreover, a materialisation of substantial contingent liabilities could put negative pressure on the credit ratings.

CREDIT RATING RATIONALE

Fiscal Deficits are Projected to Widen in Coming Years on the Back of Higher Spending on Defence, Infrastructure and Pensions

Fiscal pressures are still lower than in most other major advanced economies but are projected to rise in coming years on the back of higher defence and infrastructure spending and rising ageing costs. Germany's general government budget deficit amounted to 2.7% of GDP in 2024, compared with an average deficit of 4.4% for the other G7 countries. For 2025, the Joint Economic Forecast (JEF) by leading economic think tanks forecasts a temporary narrowing of the fiscal deficit to 2.2% of GDP as public revenues benefit from an increase in social contribution rates and the expiration of temporary tax benefits. Beyond 2025, however, budgetary pressures are likely to be raised by the planned increase in defence and infrastructure spending, although the scale of spending increases in coming years remains uncertain at this point in time due to potential production and planning bottlenecks. The JEF forecasts a gradual widening of the fiscal deficit to 3.1% of GDP in 2026 and 3.4% in 2027 whereas the European Commission projects the deficit at 4.0% in 2026 and 3.8% in 2027, assuming a faster ramp-up of spending. In terms of defence spending, the central government's medium-term budgetary plan projects a gradual increase in (core) defence spending from 2.0% of GDP in 2024 to 2.8% in 2026 and 3.6% in 2029 (NATO-definition). This increase was facilitated by the loosening of the constitutional debt brake in March 2025 which exempted defence spending above 1% of GDP from the stipulations of the debt brake. Furthermore, the creation of a EUR 500 billion special fund for infrastructure and climate spending over the next 12 years outside the debt brake has raised the government's leeway for stepping up investment spending. Central government investment spending (including special funds) is planned to be raised from 1.6% of GDP in 2024 to an annual average of 2.3% during the years 2026-2029 (excluding additional transfers to the Länder and financial transactions). Moreover, the government plans to implement additional deficit-raising measures such as a reduction in the VAT rate for restaurants, additional pension benefits for mothers and an increase in the tax allowance for commuters. The fiscal space for the latter measures was partly created by a shift of already planned infrastructure projects from the core budget to the special fund.

While the recent change in the debt brake for defence and infrastructure spending has also increased the government's short-term fiscal leeway for other budgetary purposes, the stipulations of the debt brake are projected to become more binding again in the medium-term. According to the central government's current medium-term budgetary plan, compliance with the revised debt brake necessitates a fiscal consolidation need of above 1% of GDP from 2028 onwards which can primarily be ascribed to a marked increase in pension and interest expenditure over the medium-term. On a current policy basis, the central government's annual budgetary contribution to the public pension system is projected to rise by EUR 38 billion (0.9% of GDP 2024) between 2024 and 2029. In addition, compliance with EU fiscal rules, particularly over the longer-term, is likely to confront the government with tough budgetary choices. In terms of the latter, Morningstar DBRS takes the view that a prioritization of fiscal measures which are likely to raise the resilience and the growth potential of the economy would also strengthen fiscal balances over the longer-term by bolstering tax revenue growth.

Debt Affordability is Projected to Remain Very High Over the Next Years

Although public debt is projected to increase over the next years, debt affordability is likely to remain very high due to a moderate level of public debt, a still low interest burden and Germany's status as a safe haven. General government debt amounted to 62.4% of GDP in June 2025. The IMF forecasts the debt-to-GDP ratio to rise above 70% by 2029 based on the expectation that primary fiscal deficits will remain large. Morningstar DBRS takes the view that this projected increase in debt levels does not weaken Germany's credit fundamentals. At the same time, Morningstar DBRS views containing the upward trend in the debt trajectory over the longer-term as an important policy challenge. This, in turn, would most likely necessitate the adoption of significant fiscal consolidation measures and structural reforms which raise the growth potential of the economy in a sustained manner. Risks to public finances emanate from a materialization of implicit or explicit contingent liabilities both with regard to domestic companies and the currency union. While the government's interest burden is projected to increase, it continues to compare favourably with European peers and in a historical perspective. The IMF forecasts the general government's net interest burden to rise to 1.4% of GDP in 2029 from 0.9% in 2024.

Government financing benefits from the government's role as a benchmark issuer for the euro area. Germany's safe-haven status as well as its very strong debt repayment capacity supports the "Debt and Liquidity" building block assessment.

Fiscal Stimulus is Likely to Bolster Economic Growth in Coming Years but Structural Challenges Remain

The German economy did not show signs of a clear recovery in recent months. While the economy received a temporary boost from the front-loading of exports prior to the announcement of US tariffs in early April, real GDP growth weakened again in subsequent quarters. During the first nine months of 2025, real GDP rose by a mere 0.3% on a year-on-year basis. Growth was supported by a gradual recovery in private consumption from the inflation shock, underpinned by rising real wages, and higher public consumption. At the same time, investment continued to contract amid subdued business sentiment and still elevated interest rates. Furthermore, net exports decreased as higher US tariffs and the Euro's appreciation weighed on exports whereas import volumes increased noticeably. On the production side, the economy's large manufacturing sector remained a major drag on growth. Although capacity utilization in the manufacturing sector has edged up slightly in recent months, it is still on a very low level. Looking ahead, growth dynamics are projected to gain strength in coming years, driven by higher public spending particularly for defence and infrastructure. The IMF forecasts real GDP growth to accelerate from 0.2% in 2025 to 0.9% in 2026 and 1.5% in 2027.

While the government's fiscal loosening supports growth in the short-to-medium-term, the economy continues to face structural challenges such as unfavourable demographic trends. Over the next ten years, the retirement of large age cohorts of the baby boomer generation is likely to lower labour supply markedly. This, in turn, weakens the economy's growth potential with the JEF estimating potential real GDP growth only at 0.3% over the next years, compared to a rate of 1.5% in the mid-2010s. Moreover, important manufacturing industries such as automotives, machinery & equipment, chemicals and base metals face headwinds from structural changes such as the automotive industry's transformation towards electric vehicle production, higher energy prices and the emergence of new competitors particularly from China. Therefore, strengthening the international competitiveness of the economy is likely to require sustained policy efforts particularly with regard to lowering energy prices, bolstering the supply of labour, streamlining business regulations and incentivizing private investment. Notwithstanding these challenges, the economy's overall strength remains high, underpinned by a high level of labour productivity and the economy's highly developed nature.

Financial Condition of the Banking Sector Is Sound but Banks are Exposed to Downside Risks

Financial stability is supported by the banking sector's good capital buffers. The average Tier 1 capital adequacy ratio stood at 17.9% in March 2025. Banks' asset quality has been weakened by the challenging economic environment and the interest rate shock but remains sound. The NPL ratio rose to 1.7% in March 2025 from 1.2% two years earlier, driven by higher NPL for exposures towards the commercial real estate (CRE) industry, a substantial part of which relates to the US. Looking ahead, pockets of vulnerability might arise from banks' exposure to CRE (15.7% of total domestic private loans in June 2025) and, to a lesser extent, to the manufacturing (4.3%) and the construction (3.3%) sectors. While CRE prices have stabilized, vacancy rates for offices continued to increase. Moreover, CRE borrowers face repricing risks over the next years and segments such as retail and office are exposed to structural challenges such as a rising importance of remote work and e-commerce. In terms of household mortgages (37.5% of total domestic private loans in June 2025), the pass-through of higher interest rates has been contained by long interest rate fixation periods of most mortgages. Furthermore, households' repayment capacity is supported by the comparatively low level of household debt (49% of GDP in Q2 2025). Banks are exposed to downside risks from a potential marked increase in risk aversion on global capital markets as the latter might lead to significant market valuation losses in banks' bond portfolios. Stress tests by the Bundesbank show that a potential increase in government bond yields of high-debt Euro area countries would weaken capital buffers of German banks markedly, particularly if accompanied by rising risk weights on credit exposures to banks in these countries. In view of the downside risks particularly with regard to CRE loans and market risks, Morningstar DBRS takes a cautionary approach and applies a negative qualitative adjustment to the `Monetary Policy and Financial Stability' building block assessment.

External Finances Remain Strong

While external headwinds for Germany's export industries have increased, external finances remain strong. The JEF forecasts the current account surplus to narrow from 5.8% of GDP in 2024 to a still large 5.1% in 2025 and 4.7% in 2026 as headwinds for key export industries are likely to persist and strengthening domestic demand is likely to raise import demand. Furthermore, Morningstar DBRS assesses Germany's external liquidity risks in case of a potential global financial shocks as low given Germany's status as a safe haven and its large net external asset position. In Q2 2025, Germany's net international investment position amounted to a large 76% of GDP owing to substantial foreign assets held particularly by non-depository financial institutions and, to a lesser extent, the central bank. This strong net external creditor position supports the "Balance of Payments" building block assessment.

Germany's Rating Is Underpinned by High Institutional Quality

Germany's high institutional quality is a key strength of its credit profile. Germany is a strong performer on the World Bank's Governance Indicators reflecting a high rule of law, low levels of corruption and stable political and economic institutions. Germany's new coalition government which was formed between the center-right Christian Democrats and the center-left Social Democrats in May 2025 faces large challenges such as raising the country's defence capabilities, strengthening the economy's low growth potential and addressing rising ageing-related costs. At the same time, the coalition government has only a narrow majority in parliament and political polarization - though still less pronounced than in some other advanced economies - has increased. Therefore, addressing major economic and fiscal challenges will require a strong degree of cohesion within the government coalition in coming years. A rising domestic political polarization was exemplified by the results of the parliamentary election in February 2025 which led to a declining share of parliamentary seats for more centrist political parties. This, in turn, is likely to complicate the government's aim to reform the constitutional debt brake in a general manner during the current legislative term as this requires a two thirds majority in parliament. Moreover, a potential further decline in employment levels in key industries such as car manufacturing might raise political polarisation in affected areas.

ENVIRONMENTAL, SOCIAL, AND GOVERNANCE CONSIDERATIONS

There were no Environmental, Social or Governance factors that had a significant or relevant effect on the credit analysis.

A description of how Morningstar DBRS considers ESG factors within the Morningstar DBRS analytical framework can be found in the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings (16 May 2025) https://dbrs.morningstar.com/research/454196.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments. https://www.dbrsmorningstar.com/research/468674.

EURO AREA RISK CATEGORY: LOW

Notes:
All figures are in euros unless otherwise noted. Public finance statistics reported on a general government basis unless specified.

The principal methodology is the Global Methodology for Rating Sovereign Governments (09 July 2025) https://dbrs.morningstar.com/research/457952. In addition Morningstar DBRS uses the Morningstar DBRS Criteria: Approach to Environmental, Social, and Governance Factors in Credit Ratings https://dbrs.morningstar.com/research/454196 in its consideration of ESG factors.

The credit rating methodologies used in the analysis of this transaction can be found at: https://dbrs.morningstar.com/about/methodologies.

The sources of information used for these credit ratings include Germany's Federal Ministry of Finance (German Medium-Term Fiscal-Structural Plan, August 2025; Draft Budgetary Plan 2026, October 2025; Monthly Reports), Federal Government (Medium-Term Budgetary Plan 2025-2029; Budget 2025; Budget 2026), German Finance Agency (Deutsche Finanzagentur), Deutsche Bundesbank (Monthly Reports; Financial Stability Review 2025, November 2025), Federal Ministry for Economic Affairs and Energy, Federal Statistical Office, Federal Financial Supervisory Authority (BaFin), European Banking Authority, German Council of Economic Experts (Annual Report 2025-26, November 2025), Ifo Institute (Joint Economic Forecast, September 2025), European Commission (European Economic Forecast Autumn 2025, November 2025; Commission Assessment of Germany's Medium-Term Fiscal-Structural Plan, September 2025), Statistical Office of the European Communities, European Central Bank (ECB), IMF (World Economic Outlook October 2025; International Financial Statistics), OECD, BulwienGesa AG (Housing Price Index), NATO, European Environment Agency, German Environment Agency, World Bank, Bank for International Settlements and Macrobond. Morningstar DBRS considers the information available to it for the purposes of providing these credit ratings to be of satisfactory quality.

With respect to FCA and ESMA regulations in the United Kingdom and European Union, respectively, these are unsolicited credit ratings. These credit ratings were not initiated at the request of the issuer.

With Rated Entity or Related Third Party Participation: YES
With Access to Internal Documents: NO
With Access to Management: NO

Morningstar DBRS does not audit the information it receives in connection with the credit rating process, and it does not and cannot independently verify that information in every instance.

The conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. Morningstar DBRS' outlooks and credit ratings are under regular surveillance.

For further information on Morningstar DBRS historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: https://registers.esma.europa.eu/cerep-publication. For further information on Morningstar DBRS historical default rates published by the Financial Conduct Authority (FCA) in a central repository, see https://data.fca.org.uk/#/ceres/craStats.

The sensitivity analysis of the relevant key credit rating assumptions can be found at: https://www.dbrsmorningstar.com/research/468673.

These credit ratings are endorsed by DBRS Ratings Limited for use in the United Kingdom.

Lead Analyst: Yesenn El-Radhi, Vice President, Global Sovereign Ratings
Rating Committee Chair: Thomas R. Torgerson, Managing Director, Global Sovereign Ratings
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DBRS Ratings GmbH
Neue Mainzer Straße 75
D-60311 Frankfurt am Main
Tel. +49 (69) 8088 3500
Geschäftsführung: Detlef Scholz, Marta Zurita Bermejo
Amtsgericht Frankfurt am Main, HRB 110259

For more information on this credit or on this industry, visit dbrs.morningstar.com.

Ratings

Germany, Federal Republic of

Date Issued	Debt Rated	Action	Rating	Trend	Attributes
28-Nov-25	Long-Term Foreign Currency – Issuer Rating	Confirmed	AAA	Stb	EU U
28-Nov-25	Long-Term Local Currency – Issuer Rating	Confirmed	AAA	Stb	EU U
28-Nov-25	Short-Term Foreign Currency – Issuer Rating	Confirmed	R-1 (high)	Stb	EU U
28-Nov-25	Short-Term Local Currency – Issuer Rating	Confirmed	R-1 (high)	Stb	EU U

Contacts

Yesenn El-Radhi
Vice President - Global Sovereign Ratings
+(49) 69 8088 3517
yesenn.el-radhi@morningstar.com

Thomas R. Torgerson
Managing Director – Global Sovereign Ratings
+(1) 212 806 3218
thomas.torgerson@morningstar.com