# Federal Republic of Germany (Germany)

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**METHODOLOGY**

[Sovereigns: Sovereigns Rating Methodology]

**ECONOMIC SNAPSHOT**

| | 2025 |
|---|---|
| Per Capita Income (US$, PPP) | 74,004 |
| Real GDP Growth (% Change) | 0.2 |
| Inflation Rate (Average %) | 2.3 |
| Budget Balance (% GDP) | -2.8 |
| Current Account Balance (% GDP) | 4.4 |
| External Debt (% GDP) | 150 |
| Level of Economic Development | Very high |
| Default History | None recent |

## Ratings

| Description | Rating Action | Rating/Outlook or Watch |
|---|---|---|
| **Federal Republic of Germany** | | |
| Foreign Currency LT | Affirmed | AAA/Stable |
| Local Currency LT | Affirmed | AAA/Stable |
| Foreign Currency ST | Affirmed | K1+ |
| Local Currency ST | Affirmed | K1+ |

## Executive Summary

KBRA affirms the Federal Republic of Germany (Germany) long-term issuer ratings. KBRA also affirms the short-term issuer ratings of the sovereign.

## Ratings Outlook

Germany's long-term ratings carry a Stable Outlook. The Outlook reflects Germany's large, diversified, and globally important economy, tremendous access to liquidity, economic resilience, robust governance, institutional framework, prudent policy environment, and healthy public finance position. The sovereign's fiscal capacity and financial flexibility allow it to respond comfortably to external shocks. The Outlook also takes into account that the political leadership will need to navigate weak growth, rising geopolitical and trade tensions, including the adverse impact of tariffs, while Germany's new fiscal strategy, centered on expanded capital spending, could provide support to medium-term growth.

## Key Credit Considerations

The ratings were affirmed because of the following key credit considerations:

### Economic Diversification and External Strength Support Credit Quality

Germany's large, advanced, and highly diversified economy underpins its sovereign credit profile. As Europe's largest economy and a leading global exporter, Germany benefits from a broad productive base and significant international competitiveness. Its longstanding current account surpluses and large positive net international investment position (NIIP) reinforce the country's external position and substantial capacity to absorb external shocks.

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### Sound Fiscal Position Underpins Financing Flexibility

Germany's comparatively moderate public debt burden and robust fiscal framework provide substantial fiscal flexibility relative to advanced-economy peers. In KBRA's view, the Bund's position as Europe's benchmark safe asset supports deep and reliable market access, broad investor demand, and favourable financing conditions granting the country extremely strong access to liquidity. While the ongoing fiscal expansion will increase government debt, Germany enters this period from a comparatively sound balance-sheet position.

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### Strong Institutions and Global Geopolitical Importance

Germany benefits from strong governance, effective institutions, and a consensus-oriented policymaking framework that support policy continuity and creditworthiness. Its central economic and political role within the European Union (EU) and euro area, together with its broader geopolitical importance, further strengthens its institutional profile.

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### Germany's Industrial Model Faces Structural Change

Germany's comparatively large manufacturing and export sectors expose the economy to shifts in global trade and increasing competition, particularly from China. Traditional areas of comparative advantage, including automotive and mechanical engineering, face intensifying market pressures. The transition towards higher-value-added domestic activities presents opportunities but also requires significant adjustment in investment, technology, and workforce skills.

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### Weak Potential Growth Amid Demographic and Productivity Pressures

Germany's medium-term growth capacity is constrained by population ageing, a shrinking labour supply, persistent skills mismatches, and subdued productivity growth. Ongoing reforms provide scope for improvement, although their effectiveness will be important in determining the medium-term outlook.

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## Rating Sensitivities

There is no upward pressure on Germany's ratings at the highest rating level.

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Negative rating pressure could arise if Germany reports persistent budget deficits and is unable to stabilise or reduce its government debt-to-GDP burden. A significant and prolonged recession could also exert downward pressure on the ratings. A deterioration in Germany's access to liquidity would be a serious rating consideration.

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## K-Sov and Rating Methodology Steps

| **Germany Sovereign Credit Rating K-Sov** | |
|---|---|
| **Rating Determinant** | **Equivalent Rating Range** |
| Macroeconomic Performance | A |
| Government Financial Strength | AAA/AA |
| External Vulnerability | AAA |
| Structural Robustness | AAA/AA |
| **K-Sov Germany** | **AAA/AA range** |

Determining the K-Sov is the first step of KBRA's Sovereign Ratings Methodology. Germany's K-Sov stands at the top end of the rating scale. This strong performance reflects the large size and global importance of the German economy, healthy public finance position, high degree of financing flexibility, and robust external account position. The macroeconomic performance rating determinant reflects a stable environment overall, although in recent years modest real GDP growth and higher inflation have weighed down this determinant. Germany's access to liquidity is overweighted in the K-Sov. Its structural robustness indicators are characterised by a centrist and consensus-based policy framework, central role in the EU, and global geostrategic importance. The second step considers trend analysis, peer comparisons, additional metrics and factors influencing credit risk that may not be included in the K-Sov analytics, as well as willingness to pay. These items are highlighted within each section. Finally, the alignment of foreign currency and local currency sovereign ratings is determined.

# Macroeconomic Credit Metrics

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | 2023 | 2024 | 2025 | 2026e | 2027f |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Gross Domestic Product USD bn | 3,764 | 4,057 | 3,960 | 3,938 | 4,358 | 4,204 | 4,564 | 4,684 | 5,048 | 5,453 | 5,642 |
| Real GDP Growth | 2.8 | 1.1 | 1.0 | -4.1 | 3.9 | 1.8 | -0.9 | -0.5 | 0.2 | 0.7 | 0.9 |
| Population mns | 82.0 | 82.2 | 82.2 | 82.1 | 82.0 | 82.5 | 83.3 | 83.5 | 83.5 | 83.5 | 83.4 |
| Total Credit/GDP | 202.6 | 200.4 | 201.9 | 226.3 | 222.4 | 206.4 | 199.0 | 196.8 | 195.6 | - | - |
| to Government | 63.9 | 60.7 | 58.6 | 68.2 | 68.1 | 64.5 | 62.3 | 62.2 | 63.4 | - | - |
| to Households | 51.8 | 51.5 | 52.4 | 56.1 | 55.3 | 53.2 | 50.6 | 49.6 | 48.9 | - | - |
| to Private Corp. | 82.1 | 83.3 | 85.2 | 92.8 | 92.3 | 93.1 | 89.0 | 88.1 | 87.8 | - | - |
| Savings/GDP | 28.8 | 30.1 | 29.3 | 28.0 | 29.6 | 27.1 | 27.5 | 27.3 | 26.3 | 25.4 | 25.4 |
| Investment/GDP | 20.7 | 21.7 | 21.4 | 21.7 | 22.7 | 23.3 | 22.0 | 21.5 | 21.9 | 21.5 | 21.6 |
| Current Account Balance/GDP | 8.1 | 8.4 | 7.9 | 6.3 | 6.9 | 3.8 | 5.5 | 5.8 | 4.4 | 3.9 | 3.8 |
| Net International Investment Position/GDP | 44.2 | 52.6 | 58.7 | 64.4 | 69.9 | 70.0 | 68.5 | 80.2 | 82.3 | - | - |
| Inflation (HICP) YoY | 1.7 | 1.9 | 1.4 | 0.4 | 3.2 | 8.7 | 6.0 | 2.5 | 2.3 | 2.9 | 2.7 |
| Unemployment Rate | 3.5 | 3.2 | 3.0 | 3.6 | 3.6 | 3.1 | 3.1 | 3.4 | 3.8 | 3.9 | 3.5 |
| ECB Refinancing Rate - Year-end | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 2.5 | 4.5 | 3.2 | 2.2 | - | - |
| 10-Year Bonds % - Year-end | 0.4 | 0.2 | -0.2 | -0.6 | -0.2 | 2.6 | 2.0 | 2.4 | 2.9 | - | - |
| General Government Revenues/GDP | 45.9 | 46.5 | 46.9 | 46.7 | 47.5 | 46.7 | 45.7 | 46.8 | 47.9 | 47.9 | 47.8 |
| General Government Expenditures/GDP | 44.5 | 44.7 | 45.5 | 51.1 | 50.7 | 48.6 | 48.1 | 49.4 | 50.5 | 51.7 | 52.1 |
| Fiscal Interest/Revenues | 1.8 | 1.6 | 1.3 | 1.0 | 1.0 | 1.2 | 1.4 | 1.7 | 1.8 | 2.0 | 2.3 |
| General Government Balance/GDP | 1.3 | 1.9 | 1.3 | -4.4 | -3.2 | -1.9 | -2.5 | -2.7 | -2.8 | -3.8 | -4.2 |
| General Government Cyclically Adjusted Balance/Potential GDP | 0.8 | 1.4 | 1.1 | -3.0 | -2.8 | -2.6 | -2.4 | -2.1 | -2.1 | -3.3 | -4.0 |
| Primary Balance/GDP | 2.2 | 2.6 | 1.9 | -3.9 | -2.7 | -1.3 | -1.9 | -1.9 | -1.8 | -2.8 | -3.2 |
| Gross Government Debt/GDP | 64.0 | 60.8 | 58.7 | 68.0 | 67.9 | 64.4 | 62.3 | 62.2 | 63.5 | 64.6 | 66.5 |
| Gross Government Debt/Revenues | 139.5 | 130.6 | 125.2 | 145.6 | 143.0 | 137.9 | 136.6 | 133.1 | 131.4 | 134.9 | 139.0 |
| Net Government Debt/GDP | 44.7 | 42.1 | 39.8 | 45.3 | 46.2 | 45.8 | 45.7 | 46.0 | 47.2 | 49.4 | 51.9 |
| Net Government Debt/Revenues | 97.5 | 90.4 | 85.0 | 97.0 | 97.2 | 98.1 | 100.0 | 98.3 | 98.5 | 103.1 | 108.4 |

*Sources: National Sources, IMF World Economic Outlook, IMF Fiscal Monitor, UN, World Bank, World Economic Forum, EC, Eurostat, BIS, Bloomberg*

# Step I: K-Sov Scorecard Analysis

## Macroeconomic Performance

Germany's large, advanced, and highly diversified economy, together with its position as a leading global exporter and major industrial centre, underpins its macroeconomic strength. As the world's third-largest economy and the largest in Europe, Germany benefits from a broad economic base, with industry accounting for roughly 23% of gross value added in 2025, well above the EU-27 average of 19%. A distinguishing feature relative to other major advanced economies is the importance of manufacturing and merchandise exports, which make significant contributions to output and employment but also leave the economy comparatively exposed to shifts in global trade and external demand. Real GDP growth averaged 1.8% over 2015–19, below Canada (1.9%) and the US (2.6%), two of its main rating peers, partly reflecting systemic rigidities and subdued productivity growth. In recent years, population ageing, elevated energy costs, regulatory and administrative burdens, investment shortfalls, and weakening competitiveness in key industrial sectors have weighed on economic performance. These structural constraints, together with elevated geopolitical and trade uncertainty, continue to limit Germany's underlying growth potential, although moderate economy-wide leverage provides an important source of resilience and helps mitigate broader macroeconomic credit risks.

| Rating Determinant 1: Macroeconomic Performance (20%) | Equivalent Rating Range |
|---|---|
| Nominal GDP ($B) | AAA/AA |
| Nominal GDP Growth (%) | BBB |
| Real GDP Growth (%) | BBB |
| Inflation (%) | A/BBB |
| Unemployment (%) | AAA/AA |
| **K-Sov Macroeconomic Performance** | **A** |

## Domestic Demand Will Support Gradual Recovery Amid Structural Constraints

Germany's post-pandemic recovery has lagged that of the broader euro area. According to the IMF, real GDP contracted by 0.9% in 2023 and 0.5% in 2024 before expanding marginally by 0.2% in 2025, amid weak investment, subdued productivity growth, and erosion of competitive position across the industrial sector. These pressures have been particularly pronounced in Germany's export-oriented manufacturing sector, where higher US tariffs, euro appreciation, and intensifying pressure from Chinese producers have weighed on export performance. In light of this, Germany's industrial model is gradually evolving, with some physical production relocating abroad while higher-value-added activities are retained domestically. See Step II for further discussion. Signs of improvement emerged in late 2025, supported by a marked rebound in new orders, particularly from domestic and defence-related demand. Despite renewed geopolitical tensions in the Middle East and continued weakness in parts of industry, more recent indicators point to improving sentiment. The ifo Business Climate Index in August 2026 returned broadly to its February level, while the recent pickup in lending to non-financial corporations marks a notable shift from the weak or declining credit dynamics observed in previous quarters and, in KBRA's view, provides further evidence of a steady recovery.

The recovery is nevertheless expected to remain gradual and increasingly reliant on domestic demand and fiscal support. The Bundesbank forecasts real GDP growth of 0.7% in 2026 and 0.9% in 2027, with expansionary fiscal policy providing a significant impulse through higher infrastructure and defence expenditure. Public investment is expected to be a particularly important driver, with government gross fixed capital formation (GFCF) projected to increase by 13.3% in 2026 and 9.4% in 2027, well above its average annual growth of 4.1% over 2015–19. By contrast, private investment remained below its 2015 level in 2025, reflecting persistent weakness in manufacturing and construction. While the effects of fiscal stimulus on production may materialise with a lag, KBRA expects the combination of higher public expenditure and improving sentiment to increasingly support economic activity. Private consumption should also gradually strengthen as wage growth bolsters household incomes, although renewed energy-driven inflation is likely to constrain purchasing power in the near term. Against this backdrop, domestic demand is expected to become the principal driver of growth, while the external sector makes a comparatively limited contribution. Net exports are projected to weigh on growth in both 2026 and 2027, although the drag should diminish thereafter as export growth accelerates and import growth moderates. The cyclical recovery does not, however, eliminate Germany's longer-term growth challenges, with potential growth projected by the European Commission (EC) to remain below the EU average through 2030. In KBRA's view, ongoing reforms and higher public investment could alleviate some of these constraints, although their effectiveness in strengthening productive capacity will depend on implementation and the extent to which they generate sustained productivity gains.

Inflationary pressures are expected to accelerate in 2026, temporarily interrupting the disinflation trend that followed the 2022 peak. After moderating to 2.3% in 2025, HICP inflation is projected by the Bundesbank to rise to 2.9% in 2026 and remain elevated at 2.7% in 2027, broadly in line with the euro area in 2026 before exceeding it in 2027. The temporary increase largely reflects higher energy costs following the escalation of the conflict in the Middle East in March 2026. Temporary fuel-tax relief introduced in May partly cushioned the initial impact but expired at end-June. KBRA sees the energy shock as likely to delay rather than derail disinflation, with core inflation also expected to decline gradually, even as wage growth sustains services inflation and higher energy costs feed through to firms' input costs. Moderating unit labour cost growth over the next years should partly alleviate domestic price pressures. According to the Bundesbank, HICP inflation is indeed projected to fall to 1.9% in 2028, partly reflecting the effect of the EU ETS2 and bringing inflation broadly in line with the European Central Bank's (ECB) 2% target. That said, KBRA believes that geopolitical risks and ongoing trade tensions could create upside risks to the inflation outlook.

Labour market conditions have continued to soften despite the gradual recovery in economic activity. Employment fell by 0.5% yoy in Q2 2026, contrasting with 0.5% growth across both the EU and euro area, with job losses concentrated in manufacturing and construction. Nevertheless, labour market remains comparatively tight: the EC projects Germany's (harmonised) unemployment rate to increase from 3.8% in 2025 to 4.0% in 2026, before easing to 3.9% in 2027, well below the EU average of 6.0% throughout the same period. Weak labour demand also suggests that the improvement in economic activity will translate into stronger employment only with a lag, with the Bundesbank expecting more meaningful employment gains from around mid-2027. Wage pressures have meanwhile moderated markedly from their post-pandemic peak. Negotiated wages increased by 2.5% in 2025, down from 6.2% in 2024 and 4.0% in 2023, according to the Bundesbank. Softer labour demand should contain wage pressures in the near term, although demographic ageing and persistent skilled-worker shortages are likely to maintain some upward pressure on labour costs as the economy recovers. Improving productivity provides a more positive counterpoint to softer employment dynamics. Following several years of subdued performance, labour productivity growth is expected to strengthen as output recovers faster than employment. However, Germany's productivity performance remains comparatively modest, reflecting longstanding constraints. In KBRA's view, sustained productivity gains will become increasingly important as population ageing reduces labour supply and limits the contribution of employment to potential growth.

## Government Financial Strength

Germany's historically prudent fiscal stance has provided substantial fiscal space and supported a comparatively low government debt burden. However, fiscal policy has now shifted onto a deliberately more expansionary trajectory. Following the 2025 constitutional reform, borrowing for defence expenditure above 1% of GDP is exempt from the federal debt brake, the newly established EUR500 billion Infrastructure and Climate Neutrality Fund can borrow outside the rule over a 12-year period, and the Länder have been granted collective structural borrowing capacity of up to 0.35% of GDP. The federal government otherwise remains subject to the debt brake's structural net borrowing limit of 0.35% of GDP. The resulting fiscal expansion is sizeable but planned. The Bundesbank estimates that the general government deficit will rise from 2.8% of GDP in 2025 to around 5% by 2028, while the debt ratio increases from 63.5% to roughly 70% of GDP, mainly reflecting higher defence and infrastructure expenditure, alongside tax reductions, transfers, social spending and higher interest costs. Germany also remains subject to the EU fiscal framework, including the 3% deficit and 60% debt reference values and its country-specific medium-term net expenditure path, although the EU defence escape clause provides additional temporary flexibility. In KBRA's view, the shift represents a material change from Germany's previous emphasis on balanced budgets and debt reduction, but does not in itself indicate weaker fiscal governance. The expansion reflects an explicit policy choice to increase investment and defence spending within a revised rules-based framework. Germany also retains significant financing advantages, supported by the benchmark status and depth of the Bund market and exceptionally strong access to capital-market liquidity.

| Rating Determinant 2: Government Financial Strength (50%) | Equivalent Rating Range |
|---|---|
| General Government Revenues % GDP | AAA/AA |
| General Government Balance % GDP | A |
| General Government Cyclically Adjusted Balance % Potential GDP | AA/A |
| General Government Debt % GDP | AA/A |
| General Government Debt % Revenue | AAA/AA |
| General Government Interest % Revenue | AAA/AA |
| Access to Liquidity/Vulnerability to Sell-off | AAA |
| Contingent Liabilities | AAA/AA |
| Fiscal Arrears | AAA/AA |
| **K-Sov Government Financial Performance** | **AAA/AA** |

## Germany Plans for Expansionary Fiscal Policy as Debt Remains Low and Highly Affordable

Germany's fiscal expansion is being driven primarily by higher expenditure. Defence represents the largest single driver, with NATO-defined spending expected to rise from 2.4% of GDP in 2025 to 3.5% by 2031, according to IMF figures. Public investment is also increasing, with spending expected to rise from 3.3% of GDP in 2025 to 3.7% by 2027, concentrated mainly on transport, digitalisation and other infrastructure. Pension, healthcare and other social spending will remain under pressure as population ageing places growing demands on the social security system. However, KBRA expects planned pension and healthcare reforms to help contain associated costs over time, despite some measures adding to costs in the near term. See Step II for further discussion. In KBRA's view, the composition of fiscal expansion is important. A meaningful share of the additional borrowing is directed towards productive investment, which should support domestic demand and potential growth and partly offset the fiscal cost of higher borrowing.

Tax revenue has been softer than expected so far in 2026, rising by 0.8% in the first half of the year compared with the 1.2% increase assumed in the official full-year estimate. Wage tax receipts have remained relatively resilient, but profit-related and corporate tax revenues have weakened. This comes as the government is deliberately reducing parts of the tax burden to improve investment and competitiveness. Measures include accelerated depreciation for equipment, an expanded R&D tax allowance, a lower VAT rate for restaurants and a phased reduction in the federal corporate income tax rate from 15% to 10% between 2028 and 2032. Further increases in income tax allowances and child benefits are planned for 2027 and 2028, partly offset by higher taxation of very high incomes and reductions in selected tax reliefs. Higher social insurance contributions should partly offset these measures, leaving the overall revenue ratio broadly stable in the near term. For KBRA, the policy mix represents a trade-off between weaker near-term revenue collection and measures intended to strengthen longer-term productive capacity.

The fiscal challenge becomes more pronounced later in the decade. Structural tax revenue is expected to grow by around 2.5% annually between 2028 and 2030, barely sufficient to cover the planned increase in federal transfers to the pension system, while rising interest expenditure adds a further, albeit still modest, budgetary burden. The government's medium-term fiscal plan also assumes EUR48 billion of consolidation measures in 2030 that have not yet been specified. In practical terms, this amount still needs to be found through spending restraint, additional revenue measures or a combination of both for the existing plan to remain consistent with the debt brake. Without this adjustment, the Bundesbank estimates that the structural deficit could exceed 5% of GDP in 2030. The IMF expects the general government deficit to average around 3.9% of GDP between 2027 and 2031, significantly wider than the roughly 1% average over the previous decade, while public debt is projected to rise to 73.4% of GDP by 2031.

Nevertheless, German public debt will continue to stand at a much lower level than that of European and major advanced economy peers. German net government debt averaged 46% of GDP over the last five years and is forecast to increase to 56% over the next five years, remaining well below levels in France, the UK, Italy and Spain.

Germany is also well positioned to meet its higher borrowing requirements, supported by substantial cash buffers, very deep capital market access and the Bund's status as a European fixed income benchmark. Despite the increase in borrowing, funding costs remain manageable. The average cost of debt has risen modestly to 1.7%, while government interest expenditure has increased from 0.5% of GDP in 2021 to 0.9% and is projected by the IMF to reach a still modest 1.5% by 2030. The average maturity of German government debt, at 7.7 years, also helps contain refinancing risk. In KBRA's view, these factors underpin Germany's exceptional financing flexibility and extremely strong access to liquidity, supporting the overweighting of this Rating Sub-determinant in the K-SOV scorecard.

## External Vulnerability

KBRA views Germany's external vulnerabilities as low, supported by high current account surpluses that averaged about 6.7% of GDP between 2015 and 2025, and by a sizeable positive NIIP. These reflect Germany's diversified industrial base, status as a leading global exporter, and elevated savings rate relative to peers. Germany's current account surplus has typically ranked near the highest among G20 economies since 2015, highlighting the resilience of its external position. While trade momentum has slowed recently, fundamentals such as a high savings rate and the presence of high value-added industries typically support recovery after temporary downturns, though global trade headwinds present greater challenges this time. Germany's NIIP has consolidated materially, rising to 86% of GDP in Q1 2026 from a recent 10-year average of around 58%, reflecting persistent current account surpluses, sustained investment abroad and valuation gains on foreign assets. The resulting large net external asset position supports Germany's sizeable primary income surplus.

| Rating Determinant 3: External Vulnerability (10%) | Equivalent Rating Range |
|---|---|
| Current Account Balance % GDP | AAA |
| **K-Sov External Vulnerability** | **AAA** |

### External Headwinds Persist Despite a Significant Structural Current Account Surplus

The global economic environment, characterised by weak demand, trade fragmentation, and elevated geopolitical uncertainty, continues to weigh on Germany's growth and trade outlook. Although around half of German exports remain within the EU, Germany retains significant exposure to US trade, with the US accounting for around 9% of exports. Higher US tariffs have already weighed on trade, with exports to the US falling by around 9% in 2025. Prior to the subsequent reduction in US tariff rates in 2026, the IMF estimated that higher tariffs could reduce German GDP by around 0.2%-0.4% by end-2027. Trade with China has also softened since 2022, as German exports of machinery and electrical equipment have stagnated or declined, underscoring Germany's vulnerability to shifts in global supply chains and heightening pressure from foreign producers in advanced technology sectors. According to Destatis, China was Germany's main trading partner in 2025 (considering both exports and imports). Germany's share of global exports has steadily eroded over the past 15 years, reflecting a broader loss of competitiveness. Weakness in industrial and construction output persists, with monthly industrial production remaining broadly flat over the past two years, while factory orders have also remained subdued. Motor vehicles, which were Germany's main export product in 2025, remain under strain as Chinese producers gain ground and the transition to electric vehicles progresses slowly. Despite these pressures, the IMF projects Germany will sustain a current account surplus averaging 3.8% of GDP through 2027–31, still among the highest in the G20, albeit narrower than in the past.

## Structural Robustness

Germany's structural characteristics are important factors underpinning its sovereign rating. The country's robust institutional framework, high degree of government effectiveness, consensus-based policymaking environment, central role in the EU and euro area and significant geopolitical influence substantiate its structural robustness, in KBRA's view. The federal coalition government, led by Chancellor Friedrich Merz since May 2025, has increasingly focused on consolidating economic growth, investment, competitiveness, and defence against a backdrop of weak domestic economic performance and heightened trade and geopolitical uncertainty. Reform implementation has continued to progress in 2026, with measures targeting taxation, pensions and social security, administrative simplification, and private investment. In KBRA's view, these initiatives could help address longstanding investment shortfalls and strengthen Germany's medium-term growth capacity, although their effectiveness will depend on implementation and the extent to which higher public spending raises productivity and crowds in private investment. KBRA also believes that Germany's banking sector remains resilient despite the challenging macroeconomic environment, supported by sound capital and liquidity buffers. However, pockets of credit risk, particularly in commercial real estate, alongside profitability and cost pressures remain key challenges. Overall, strong financial buffers provide substantial capacity to absorb adverse shocks.

| Rating Determinant 4: Structural Robustness (20%) | Equivalent Rating Range |
|---|---|
| Socio-Political Risk | AAA/AA |
| Security Risk | AAA/AA |
| Geostrategic Importance | AAA/AA |
| Systemic and Economic Risk | AAA/AA |
| Per Capita GDP (PPP Basis) | AAA/AA |
| Institutional Indicators | AAA/AA |
| **K-Sov Structural Robustness** | **AAA/AA** |

## Coalition Advances Reform Agenda Amid Heightened Political Fragmentation

Since taking office in May 2025, the coalition government led by Chancellor Friedrich Merz, comprising the Christian Democratic Union (CDU), its Bavarian sister party – the Christian Social Union (CSU) – and the Social Democratic Party (SPD), has operated within an increasingly fragmented political backdrop. Its mandate has been marked by persistent economic and geopolitical challenges, as well as rising polling support for the far-right Alternative for Germany (AfD), particularly in the run-up to regional elections scheduled for September 2026, where the AfD is expected to perform strongly in parts of eastern Germany. Mainstream parties continue to rule out cooperation with the AfD, limiting its immediate influence on federal policymaking but potentially complicating future coalition formation.

In KBRA's view, electoral gains for the AfD would likely increase pressure on the governing parties and make government formation more difficult at the state level, while a strong CDU/CSU performance could bolster Chancellor Merz's political position and support the federal coalition's reform agenda. Despite these pressures, several reforms have already been implemented, and KBRA expects the federal government to continue advancing measures across defence and security, pensions, taxation, labour markets, competitiveness, administrative simplification, and public investment. Germany's robust institutional framework and established coalition conventions continue to favour policy continuity and government stability.

## Sound Banking Sector with Manageable Asset Quality Risks

The German banking sector remains resilient overall, in KBRA's view, despite macroeconomic and geopolitical headwinds that continue to pose challenges. Bundesbank data indicate that total banking sector assets stood at EUR11.5 trillion at end-June 2026, equivalent to approximately 250% of nominal GDP. The sector remains highly fragmented, comprising a large number of small and locally oriented institutions, with the five largest banks accounting for only 35% of total banking assets in 2025, the lowest in the EU after Luxembourg, according to the ECB. Nevertheless, banks continue to play a central role in Germany's financial system, holding more than 50% of total domestic financial assets. German banking institutions' exposure to domestic government lending remains relatively constrained, accounting for around 4.2% of German banks' total assets at end-June 2026, placing Germany among the less exposed banking systems in the euro area.

German banks continue to face structural profitability pressures, although strong capitalisation and liquidity provide resilience to banking institutions during periods of stress. Both capital and liquidity adequacy remain at strong levels broadly in line with European peers, underpinning the sector's ability to absorb shocks. According to the European Banking Authority (EBA), the liquidity coverage ratio (LCR) stood at 146% in Q1 2026, below the EU average of 158%, while the common equity tier 1 (CET1) ratio reached 16.9%, slightly above the EU average of 16.2%. German banks maintained broadly stable profitability in Q1 2026, with return on equity at 8.0%, while net interest margins of 1.1% remained below the EU average of 1.6%. Structural factors continue to weigh on profitability, including relatively elevated operating costs, strong competition and the presence of institutions whose mandates place greater emphasis on stakeholder and public-policy objectives than on maximising shareholder returns.

KBRA expects asset quality to remain broadly sound, although subdued economic activity continues to generate pockets of vulnerability in parts of the corporate loan portfolio. The non-performing loan (NPL) ratio increased moderately yoy but remained relatively low at 1.6% at end-March 2026, compared with an EU average of 1.8%, according to the EBA. The increase was partly mitigated by a reduction in non-performing US real estate exposures at several large banks. Sectoral data on exposures to non-financial corporations indicate a broad-based deterioration in asset quality, with NPL ratios increasing yoy across all major sectors, although pressures were more pronounced in real estate and manufacturing. Banks have also tightened credit standards, primarily reflecting increased perceptions of credit risk.

# Step II: Peer Comparatives, Trends, Willingness to Pay

In Step II of the sovereign rating approach, KBRA evaluates peer comparisons, recent trends and outlook, and its evaluation of willingness to pay.

## Global Competition Is Driving Germany's Industrial Transformation

Germany's export-oriented industrial model is facing a structural adjustment as rising protectionism, intensifying competition from China, and increasing sectoral overlap challenge areas of longstanding German comparative advantage. The Bundesbank estimates that around 75% of Germany's recent export-market-share losses between 2021 and 2023 reflected deteriorating competitiveness, with pressures particularly evident in automotive, mechanical engineering, and electrical equipment. German manufacturers have lost significant ground in China, where domestic producers have rapidly expanded their presence in electric and hybrid vehicles, while Chinese producers have increasingly expanded into German and third-country markets. In the automotive sector, according to ifo, 43% of firms reported a weakening in their market position outside the EU, while Bundesbank data show that German motor vehicle and parts exports to China fell 33% in 2025, continuing the declining trend of the previous two years. However, KBRA believes that Germany's diversified industrial base and demonstrated capacity to adapt to changing global conditions provide important mitigating factors. As recognised also by the EC, German firms are increasingly relocating parts of physical production abroad while retaining higher-value-added activities, such as product development and distribution, domestically, as they adjust to changing global value chains and the transition towards greener and more digital production. In KBRA's view, this transformation, alongside challenges, could also provide an opportunity for the country to better align the workforce – through immigration, skilled-migration and education reforms – with changing labour-market needs.

## Fiscal Expansion and Reforms Could Provide Scope to Address Bottlenecks

The broad structural reform agenda, alongside the current expansionary fiscal policy, provides greater capacity to address Germany's longstanding growth constraints. KBRA evaluates the increase of fiscal metrics as manageable given Germany's comparatively strong fiscal position. The EUR500 billion infrastructure and climate-neutrality fund, equivalent to around 11% of 2025 GDP, can support investment across infrastructure, education, research, and digitalisation. Bundesbank simulations suggest that additional government investment could reach 0.5% of GDP by 2028. However, its estimated impact on productive capacity remains limited, with additional infrastructure investment expected to raise the level of potential output by only around 0.35%-0.5% by 2035 relative to baseline. In KBRA's view, this highlights the importance of complementary structural reforms and effective implementation. After years of investment levels falling short of underlying needs, addressing deep-rooted bottlenecks remains critical to unlocking Germany's public and private sector investment potential and to reinforcing domestic demand.

Reforms are also increasingly targeting social-spending pressures, with measures aimed at extending working lives and strengthening the long-term sustainability of the statutory pension system. According to the EC, Germany's old-age dependency ratio reached 35.9% in 2025, above the EU average of 34.5%, and it is expected to reach 44.7% by 2040, meaning that in 2040 there will be around 2.2 people of working age for every person aged 65 or over. Following recommendations from the Pension Commission in June 2026, the government plans a broader reform of the statutory pension system, including the Commission's proposal for a mandatory capital-funded component financed through additional employer and employee contributions and invested in capital markets. The final design remains subject to legislation, which the government aims to complete by end-2026. Separately, the private pension reform, effective from 2027, introduces simpler and more flexible investment products, alongside a separate proposal for state-supported retirement savings for younger generations that has not yet been enacted. In KBRA's view, these measures could gradually diversify retirement financing, expand the pool of long-term invested assets, and broaden Germany's institutional investor base, potentially providing an additional source of stable demand for long-term securities, including Bunds, although the proposed statutory framework does not prescribe investment in German government debt.

Healthcare reforms similarly seek to contain rising ageing-related expenditure and limit increases in social contribution rates. Without further measures, the government estimates the statutory health insurance financing gap could rise from EUR19 billion in 2027 to EUR44 billion by 2030. Consequently, the reform agenda combines measures to stabilise the statutory health insurance (GKV) finances with broader changes to hospital, primary and emergency care aimed at improving efficiency and containing expenditure growth. In KBRA's view, successful implementation could moderate strains on public finances and labour costs as the population ages, complementing pension reforms.

## Renewable Expansion Gradually Mitigates Energy Constraints

Energy costs remain an important constraint on Germany's industrial competitiveness, particularly for energy-intensive firms, although policy measures and continued renewable expansion provide scope for gradual improvement. Germany's final energy mix remains predominantly fossil-based, with fossil fuels accounting for more than 60% of final energy consumption in 2025. Exposure to global energy markets is amplified by import dependence, with the Federal Environment Agency reporting that around 98% of crude oil and 95% of fossil gas are imported, while gas alone accounts for approximately 27% of primary energy consumption. By contrast, the electricity transition is considerably more advanced, with renewables supplying 58.6% of domestic generation in 2025, exceeding peers like Italy and France and approaching Spain, providing scope to gradually reduce this persistent vulnerability. However, to mitigate the impact of elevated energy costs on German industry, the government has introduced an industrial electricity-price scheme for 2026–28, potentially covering around 9,500 energy- and trade-intensive companies, alongside lower electricity taxation for manufacturing, subsidies to transmission-grid fees, and the abolition of the gas-storage levy. KBRA acknowledges that these measures, together with continued renewable deployment and investment in grids and storage, could narrow the country's energy-cost disadvantage and support the retention of energy-intensive industrial activity.

## Macroeconomic Forecasts

| Macroeconomic Forecasts (2026-2030 average) | | | | | |
|---|---|---|---|---|---|
| **Trends and Projections** | **Germany** | **France** | **United Kingdom** | **Canada** | **United States** |
| GDP Growth | 0.9 | 1.0 | 1.4 | 1.6 | 2.1 |
| Inflation | 2.3 | 1.8 | 2.3 | 2.1 | 2.4 |
| Current Account Balance % GDP | 3.8 | 0.1 | -2.8 | -0.3 | -3.6 |
| Government Revenues % GDP | 47.9 | 52.8 | 41.1 | 41.7 | 30.5 |
| Government Balance % GDP | -4.0 | -4.2 | -2.7 | -2.2 | -7.5 |
| Government Primary Balance % GDP | -2.7 | -1.6 | 0.2 | -1.7 | -3.5 |
| Government Interest Payments % Revenues | 2.5 | 5.0 | 7.0 | 1.4 | 13.1 |
| Government Gross Debt % Revenues | 142.6 | 228.3 | 252.0 | 259.2 | 433.7 |
| Government Gross Debt % GDP | 68.3 | 120.5 | 103.6 | 108.0 | 132.2 |
| Government Net Debt % Revenues | 112.9 | 212.9 | 232.3 | 25.4 | 344.4 |
| Government Net Debt % GDP | 54.1 | 112.3 | 95.5 | 10.6 | 105.0 |

*Sources: IMF World Economic Outlook, IMF Fiscal Monitor, UN, World Bank, World Economic Forum*

## Comparative Statistics

| Comparative Statistics | | | | | |
|---|---|---|---|---|---|
| **2025 Data** | **Germany** | **France** | **Jnited Kingdon** | **Canada** | **United States** |
| Gross Domestic Product (USD bn) | 5,048 | 3,369 | 4,003 | 2,320 | 30,767 |
| Nominal GDP Growth (%) | 3.3 | 2.1 | 5.1 | 4.3 | 5.0 |
| Real GDP Growth (%) | 0.2 | 0.9 | 1.4 | 1.9 | 2.1 |
| Consumer Price Inflation (%) | 2.3 | 0.9 | 3.4 | 2.1 | 2.7 |
| Unemployment Rate - Latest Read | 3.8 | 7.6 | 4.9 | 6.9 | 4.3 |
| General Government Revenues % GDP | 47.9 | 52.4 | 38.3 | 42.2 | 30.9 |
| General Government Balance % GDP | -2.8 | -5.1 | -5.4 | -1.8 | -6.8 |
| General Government Cyclically Adjusted Balance % Potential GDP | -2.1 | -5.0 | -4.9 | -1.4 | -7.3 |
| General Government Gross Debt % GDP | 63.5 | 116.0 | 102.3 | 113.5 | 123.9 |
| General Government Gross Debt % Revenues | 131.4 | 221.6 | 267.4 | 269.1 | 401.2 |
| General Government Interest % Revenues | 1.8 | 3.8 | 6.8 | -0.8 | 11.8 |
| General Government Net Debt % GDP | 47.2 | 108.8 | 93.8 | 10.2 | 96.7 |
| General Government Net Debt % Revenues | 98.5 | 207.8 | 245.2 | 24.2 | 313.1 |
| Current Account Balance % GDP | 4.4 | -0.4 | -3.1 | -0.9 | -3.6 |
| Per Capita GDP (PPP) - USD (World Bank) | 74,004 | 66,276 | 65,525 | 67,013 | 89,991 |
| Average Institutional Indicators (KBRA Ranking) | AAA/AA | A | AA/A | AAA/AA | A |
| Human Development Index (Ranking) | 5 | 26 | 13 | 16 | 17 |

*Sources: IMF World Economic Outlook, IMF Fiscal Monitor, UN, World Bank, World Economic Forum*

Finally, KBRA believes that the Federal Republic of Germany has a very high willingness to honour its debt obligations.

## Step III: Local Currency vs. Foreign Currency Government Bond Ratings

KBRA has aligned Federal Republic of Germany's foreign and local currency sovereign ratings based on its membership of the euro area and financing in euro, a reserve currency.

## Conclusion

The German economy continues to face headwinds from geopolitical and trade tensions, as well as ongoing energy security concerns. A recent shift in fiscal policy marks the start of a new era of higher capital spending, adding both opportunities and risks to the outlook. While uncertainty around growth prospects persists, KBRA notes that Germany's exceptional funding flexibility and strong access to liquidity remain key pillars supporting the sovereign rating.

**Federal Republic of Germany Rating History**

| Date | Action | Rating/Outlook/Watch Status |
|---|---|---|
| 13-Nov-20 | Assigned | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 7-May-21 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 5-Nov-21 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 8-Apr-22 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 23-Sep-22 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 24-Mar-23 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 15-Sep-23 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 15-Mar-24 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 6-Sep-24 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 7-Mar-25 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 5-Sep-25 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 6-Mar-26 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |
| 4-Sep-26 | Affirmed | LT Ratings: AAA (Stable) - ST Ratings: K1+ |

### Disclosures

Further disclosures relating to this rating action are available in the Information Disclosure Forms. Additional information regarding KBRA policies, methodologies, rating scales and disclosures are available at www.kbra.com.

The ratings of the Federal Republic of Germany are unsolicited ratings. The rated entity or related third party did participate in the rating process and KBRA did not have access to the accounts and other relevant internal documents.

### Related Publications

- Sovereign Bond Supply Meets a More Demanding Market
- Middle East Conflict: Credit Implications
- European Sovereigns on Diverging Paths as Public Debt Climbs Into 2026
- Oil's Diminishing Role in Euro Area Inflation and Sovereign Credit Risk
- Energy Shock Tests Europe's Consumer and Labour Resilience

Doc ID: 1016853