Date of Release: December 3, 2021

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

Industry Group: Public Finance – Sovereigns
Region: Europe

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

KEY RATING CONSIDERATIONS

The Stable trend reflects DBRS Morningstar's view that Germany's credit fundamentals remain solid, despite the sharp macroeconomic shock from the COVID-19 pandemic. Germany's 2020 economic contraction was less severe than initial expectations in large part due to the sizeable policy response, and the 2021 recovery is ongoing even as health conditions once again deteriorate in Germany and around Europe. The government has used its ample fiscal space and the flexibility provided within its fiscal framework to support the healthcare system and the economy. While Government spending is expected to remain supportive, public sector accounts are likely to rebalance rapidly once the health and economic shocks recede.

Germany's AAA ratings are supported by its large, competitive and diverse economy, its sound public finances and strong and credible fiscal framework, and a robust external position that provides ample buffers to absorb shocks. However, the country faces long-term challenges stemming from its underlying demographic trends and contingent liabilities. The projected decline in the working-age population poses challenges to Germany's growth potential and the long-term sustainability of its public finances. Contingent liabilities, emanating from the financial sector, large state guarantees, and fiscal burden sharing within the currency union, could eventually weigh on public finances.

RATING DRIVERS

Germany is strongly placed within the AAA category. DBRS Morningstar could downgrade the ratings if the country's growth and fiscal prospects deteriorate severely enough to place the public debt-to-GDP ratio on a persistent upward trajectory. Moreover, a materialisation of substantial contingent liabilities could put negative pressure on the ratings.

RATING RATIONALE

COVID Resurgence And Supply Bottlenecks Are Complicating Germany's Economic Recovery

Following economic rebound in the second and third quarter of 2021, the recovery appears to have stalled for now. COVID-19 case counts in Germany as elsewhere in Europe once again surged from the beginning of November 2021, applying pressure to the healthcare system and forcing policymakers to reimpose mobility restrictions. New measures will again stress the contact-intensive services sector. As of November 25, 2021, 68% of the German population was fully vaccinated, according to Our World In Data. This was comparable to the EU average but lower than other large European countries. At the same time, shortages of global supplies complicate the recovery of capital investments and exports. Growth projections for this year, the EC now expects 2.7%, have thus been adjusted downward.

However, prospects for a healthy recovery next year are still strong, provided new virus variants are contained. As vaccination rates increase, including greater uptake of booster shots, health conditions should improve and restrictions ease. High household disposable income and savings rates will encourage consumption next year. The rapidly improved labour market, illustrated by the dramatic reduction of short-term workers and the unemployment rate back to pre-crisis levels, will also support domestic demand. Likewise, backlogs in manufacturing and construction are expected to unwind and translate into the rapid recovery of exports and investments next year. The EC expects the German economy to grow by 4.6% in 2022.

Price Pressure Will Temporarily Remain Above Target

Though the rise in inflation this year will be material and appears stickier than initially envisaged, DBRS Morningstar expects price pressures to eventually wane. The October 2021 consumer price index increased by 4.6% from a year earlier. Inflation is motivated by several factors, including the reversal of VAT price cuts from last year, a new carbon tax, elevated energy prices, and lingering supply bottlenecks. Net of food and energy prices, core inflation increased by 2.8% in October 2021 compared to a year earlier. Bundesbank forecasts are for inflation to approach 6% in November 2021 and remain above 3% for an extended period of time. That said, sluggish wage growth and the fading of temporary base effects will in time mute price pressures. The EC expects consumer prices to expand by 1.7% in 2023.

Germany's Extraordinary Public Sector Support Is Expected To Peak This Year

The Federal government adopted supplementary budgets in 2020 to finance support measures to contain the severe downturn caused by the coronavirus pandemic. The German Bundestag was able to do so through an exception clause that allowed it to exceed the structural deficit limit of 0.35% of GDP (the statutory debt brake rule). Support and stabilization measures were designed to assist households and businesses and to strengthen the healthcare system. The stimulus also contained measures to boost medium-term investment to address structural challenges. Economic contraction and additional public spending resulted in a 4.6% 2020 deficit, from the 2019 budgetary surplus position.

The deficit will be wider this year than last year since the pay-out of some support measures only materialized in 2021. The EC expects the deficit to peak in 2021 at 6.5% of GDP. Assuming the economic recovery persists and temporary support measures are wound down, the deficit is expected to narrow to 2.5% of GDP in 2022. While the incoming coalition government will most likely produce a new budget in 2022, reducing some clarity around Germany's fiscal stance in the coming years, DBRS Morningstar expects Germany to eventually return to compliance with its fiscal rules.

General government debt should peak in 2021. After falling below 60% in 2019, the EC expects the debt ratio to reach 71.4% in 2021. DBRS Morningstar takes the view that Germany's debt trajectory will return to a declining path. Despite the sharp increase in debt, the government benefits from very favourable financing conditions, with debt servicing expenditures expected to equal roughly half a percent of GDP each year over the forecast period. Germany continues to enjoy a safe-haven status. This supports DBRS Morningstar's positive qualitative assessment of the "Debt and Liquidity" building block.

Risks To Financial Stability Appear Manageable

German banks entered the crisis with resilient capital positions and strong liquidity. Moreover, the majority of the Landesbanken have now been restructured, reducing risks in the banking system. However, profitability has been weak and the operating environment has deteriorated with the current crisis. Net interest margin compression has put pressure on profitability amid low interest rates, constraining German bank's ability to absorb significant increases in credit costs.

The main emergent risk to financial stability stems from a potential sharp rise in insolvencies of corporates affected by the crisis. A sharp rise in insolvencies could lead to high loan defaults and losses for banks. While asset quality is still good, the full impact from the pandemic has not yet materialised, and credit costs are likely to increase. The rise in property prices is an additional legacy risk that existed prior to the pandemic. The German residential property prices index increased by 10.9% y-o-y in the second quarter of 2021, after average 6.8% per year growth from 2016 to 2020.

DBRS Morningstar is of the view that these challenges are manageable. While the crisis has been severe, the corporate sector's largely sound balance sheets and the government's liquidity support measures should limit a sharp rise in corporate failures. Likewise, there is no evidence of a debt-driven property boom. The rise in property prices reflects rising household income, immigration, and supportive credit conditions. Low private sector debt mitigates macroeconomic and financial stability risks from rising property prices. Household debt in the second quarter of 2021 was 58.1% of GDP and nonfinancial corporate debt reached 111.1% of GDP. Further mitigating risk, most mortgages in Germany are fixed-rate and homeownership is relatively low.

The German External Sector Remains One of The Strongest in Europe

Germany's competitive industrial sector in part accounts for its sizeable goods trade surplus. The coronavirus shock did not materially affect Germany's trade balance, as the decline in the exports of goods and services was broadly offset by the comparable decline in the imports of goods and services. The country's current account surplus remained above 7% of GDP in 2020. The EC expects a 6.7% of GDP surplus in 2021. Germany's strong external account savings position can also be attributed to high household and corporate savings rates, making the country a strong net creditor. Its net international investment position stood at 61.7% of GDP in 2020, from 21.0% in 2010. This strong external savings position supports DBRS Morningstar's positive qualitative assessment of the "Balance of Payments" building block.

Expect Policy Continuity On Key Macroeconomic Policymaking From The Next Government

The Social Democratic Party of Germany (SPD) emerged from the German Federal election in September 2021 as the largest party. It had not done so since 2002. The SPD took 25.7% of total votes, while the Christian Democratic Union (CDU/CSU) recorded its worst ever result with 24.1% of the vote. The SPD reached an agreement with the Greens (14.8% of the vote) and the Free Democratic Party (11.5% of the vote) on forming a coalition government. Olaf Scholz is set to succeed Angela Merkel as chancellor. The election outcome will inevitably result in change to policy direction in key areas. The new government according to its coalition treaty plans to accelerate the green and digital transitions. While greater details around the government's strategy to finance its ambitions are still forthcoming, DBRS Morningstar expects broad continuity around macroeconomic policymaking in Germany. The country is a strong performer on the World Bank's Governance Indicators.

ESG CONSIDERATIONS

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/373262.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments.

EURO AREA RISK CATEGORY: LOW

Notes:
All figures are in EUR 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 (July 9, 2021) https://www.dbrsmorningstar.com/research/381451/global-methodology-for-rating-sovereign-governments. Other applicable methodologies include DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings (February 3, 2021) https://www.dbrsmorningstar.com/research/373262/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings.

The sources of information used for this rating include Germany's Federal Ministry of Finance (2022 Draft Budget), German Finance Agency (Deutsche Finanzagentur), Deutsche Bundesbank (Monthly Report October 2021) Federal Ministry for Economic Affairs and Energy, the Federal Government, Federal Statistical Office, Federal Financial Supervisory Authority (BaFin), IFO Institute, European Commission (2021 Autumn Forecasts), Statistical Office of the European Communities, European Central Bank (ECB), IMF (World Economic Outlook October 2021), IMF (International Financial Statistics), Germany Climate Action Plan, Climate Action Tracker, Social Progress Index, World Economic Forum Global Competitiveness Index, World Bank, UNDP, BIS, Our World In Data, Haver Analytics. DBRS

Morningstar considers the information available to it for the purposes of providing this rating to be of satisfactory quality.

With respect to FCA and ESMA regulations in the United Kingdom and European Union, respectively, this is an unsolicited credit rating. This credit rating was 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

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

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

For further information on DBRS Morningstar historical default rates published by the European Securities and Markets Authority (ESMA) in a central repository, see: http://cerep.esma.europa.eu/cerep-web/statistics/defaults.xhtml. DBRS Morningstar understands further information on DBRS Morningstar historical default rates may be published by the Financial Conduct Authority (FCA) on its webpage: https://www.fca.org.uk/firms/credit-rating-agencies.

The sensitivity analysis of the relevant key rating assumptions can be found at: https://www.dbrsmorningstar.com/research/389267.

This rating is endorsed by DBRS Ratings Limited for use in the United Kingdom.

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Issuer	Debt Rated	Rating Action	Rating	Trend
Germany, Federal Republic of	Long-Term Foreign Currency - Issuer Rating	Confirmed	AAA	Stable
Germany, Federal Republic of	Long-Term Local Currency - Issuer Rating	Confirmed	AAA	Stable
Germany, Federal Republic of	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-1 (high)	Stable
Germany, Federal Republic of	Short-Term Local Currency - Issuer Rating	Confirmed	R-1 (high)	Stable

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Germany

Building Block Assessments and Rating Committee Summary

30-Nov-2021

Building Blocks	Scorecard Result	Quantitative Assessment	Net Impact of Qualitative Factors	Building Block Assessment
Fiscal Management and Policy	19.36	Very Strong	N/A	Very Strong
Debt and Liquidity	15.17	Strong/Good	+ 1 Category	Strong
Economic Structure and Performance	18.05	Strong	N/A	Strong
Monetary Policy and Financial Stability	17.77	Strong	N/A	Strong
Balance of Payments	16.32	Strong/Good	+ 1 Category	Strong
Political Environment	20.00	Very Strong	N/A	Very Strong

Overall Assessment	Composite Scorecard Result	Scorecard Rating Range	Composite Building Block Assessment	Indicative Rating Range
	88.9	AAA - AA (high)	92.2	AAA - AA (high)

Germany's Long-Term Foreign Currency - Issuer Rating AAA

Main topics discussed in the Rating Committee include: the incoming coalition government, the economic outlook, the expected performance of public sector finance, and challenges in the German banking sector. For additional details on DBRS Morningstar analysis and opinions, please see the accompanying rating report.

DBRS Morningstar Scorecard: Scoring Ranges and Associated Assessment Categories

Lower Bound	0.00	1.00	3.00	5.00	7.00	9.00	11.00	13.00	15.00	17.00	19.00
Upper Bound	0.99	2.99	4.99	6.99	8.99	10.99	12.99	14.99	16.99	18.99	20.00
Assessment Category	Very Weak	Weak	Weak/ Poor	Poor	Poor/ Moderate	Moderate	Good/ Moderate	Good	Strong/ Good	Strong	Very Strong

Germany

Scorecard Indicators

Scorecard Indicators	2015	2016	2017	2018	2019	2020	2021	2022	2023	Source	Current Scorecard Input	
Fiscal Management and Policy	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Overall Fiscal Balance (% of GDP)	1.0%	1.2%	1.3%	1.9%	1.5%	-4.3%	-6.8%	-1.8%	-0.4%	IMF WEO	13 year average	-0.5%
Government Effectiveness (Percentile Rank)	92.8	93.8	93.8	92.3	92.8	88.9	-	-	-	World Bank	5 year average	93.1
Debt and Liquidity	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
General Government Gross Debt (% of GDP)	72.3%	69.3%	65.0%	61.6%	59.2%	69.1%	72.5%	69.8%	68.0%	IMF WEO	5 year projection	63.4%
Interest Costs (% of GDP)	1.1%	0.9%	0.8%	0.7%	0.6%	0.4%	0.3%	0.3%	0.3%	IMF WEO	5 year average	0.5%
Economic Structure and Performance	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
GDP per Capita (USD thousands)	41.1	42.1	44.6	48.0	46.8	46.2	50.8	54.7	57.2	IMF WEO	10 year average	45.4
Output Volatility (%)	2.0%	2.0%	2.4%	2.4%	2.5%	2.5%	2.5%	2.4%	2.4%	IMF WEO	Latest	2.5%
Economic Size (USD billions)	3,358	3,469	3,690	3,979	3,889	3,843	4,230	4,557	4,774	IMF WEO	5 year average	3,774
Monetary Policy and Financial Stability	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Rate of Inflation (%, EOP)	0.2%	1.7%	1.5%	1.8%	1.5%	-0.7%	4.0%	1.2%	1.6%	IMF WEO	13 year average	1.5%
Total Domestic Savings (% of GDP)	198%	200%	203%	201%	209%	233%	-	-	-	ECB/IMF	Latest	233%
Change in Domestic Credit (% of GDP)	-0.7%	-0.2%	0.5%	1.9%	1.7%	9.3%	-	-	-	BIS/IMF	7 year average	0.9%
Net Non-Performing Loans (% of Capital)	17.4%	14.7%	11.9%	9.1%	6.8%	6.8%	-	-	-	IMF IFS	Latest	6.8%
Change in Property Price/GDP Index (%)	2.0%	3.1%	3.9%	3.8%	2.6%	8.3%	-	-	-	Eurostat/IMF	7 year average	3.5%
Balance of Payments	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Current Account Balance (% of GDP)	8.6%	8.5%	7.8%	7.8%	7.4%	6.9%	6.8%	6.9%	7.2%	IMF WEO	8 year average	7.4%
International Investment Position (% of GDP)	34.6%	39.2%	42.0%	52.6%	58.8%	61.7%	-	-	-	IMF	5 year average	50.8%
Share of Global Foreign Exchange Turnover (Ratio)	704.6%	675.4%	692.5%	684.7%	709.6%	711.8%	-	-	-	BIS/IMF	Latest	711.8%
Exchange Rate Classification (see footnote)	5	5	5	5	5	5	-	-	-	IMF	Latest	5
Political Environment	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**			
Voice and Accountability (Percentile Rank)	95.6	95.1	95.6	94.7	95.7	94.2	-	-	-	World Bank	5 year average	95.3
Rule of Law (Percentile Rank)	93.3	91.8	91.3	91.3	92.3	91.3	-	-	-	World Bank	5 year average	92.0

See DBRS Morningstar's Global Methodology for Rating Sovereign Governments for additional details on the methodology behind the scorecard indicators and associated scoring thresholds. Exchange Rate Classifications: Freely floating exchange rate = 1; Float = 2; Crawls, banded pegs, and other managed = 3; Stabilized = 4; Pegs, currency unions and dollarized arrangements = 5.

Rating Committee Date: 30-Nov-2021

Germany, Federal Republic of

ESG Checklist

ESG Factor		ESG Credit Consideration Applicable to the Credit Analysis:	Y/N	Extent of the Effect on the ESG Factor on the Credit Analysis: Relevant (R) or Significant (S)*
Environmental		**Overall:**	**N**	**N**
	Emissions, Effluents, & Waste	Do the costs or risks result in changes to a government's financial standing or relationship with other governments, and does this affect the assessment of credit risk?	N	N
	Carbon and GHG Costs	Does a government face coordinated pressure from a higher-tier government or from numerous foreign governments as a result of its GHG emissions policies, and does this affect the assessment of credit risk?	N	N
		Will recent regulatory changes have an impact on economic resilience or public finances?	N	N
		Carbon and GHG Costs:	**N**	**N**
	Resource and Energy Management	Does the scarcity of key resources impose high costs on the public sector or make the private sector less competitive?	N	N
		Is the economy reliant on industries that are vulnerable to import or export price shocks?	N	N
		Resource and Energy Management:	**N**	**N**
	Land Impact and Biodiversity	Is there a risk to a government's economic or tax base for failing to effectively regulate land impact and biodiversity activities?	N	N
	Climate and Weather Risks	Will climate change and adverse weather events potentially destroy a material portion of national wealth, weaken the financial system, or disrupt the economy?	N	N
Social		**Overall:**	**N**	**N**
	Human Capital and Human Rights	Compared with regional or global peers, is the domestic labour force more or less competitive, flexible, and productive?	N	N
		Are labour or social conflicts a key source of economic volatility?	N	N
		Are individual and human rights insufficiently respected or failing to meet the population's expectations?	N	N
		Is the government exposed to heavy, coordinated international pressure as a result of its respect for fundamental human rights?	N	N
		Human Capital and Human Rights:	**N**	**N**
	Access to Basic Services	Does a failure to provide adequate basic services deter investment, migration, and income growth within the economy?	N	N
Governance		**Overall:**	**N**	**N**
	Bribery, Corruption, and Political Risks	Does widespread evidence of official corruption and other weaknesses in the rule of law deter investment and contribute to fiscal or financial challenges?	N	N
	Institutional Strength, Governance, and Transparency	Compared with other governments, do institutional arrangements provide a higher or lesser degree of accountability, transparency, and effectiveness?	N	N
		Are regulatory and oversight bodies insufficiently protected from inappropriate political influence?	N	N
		Are government officials insufficiently exposed to public scrutiny or held to insufficiently high ethical standards of conduct?	N	N
		Institutional Strength, Governance, and Transparency:	**N**	**N**
	Peace and Security	Is the government likely to initiate or respond to hostilities with neighboring governments?	N	N
		Is the government's authority over certain regions contested by domestic or foreign militias?	N	N
		Is the risk of terrorism or violence sufficient to deter investment or to create contingent liabilities for the government?	N	N
		Peace and Security:	**N**	**N**
		Consolidated ESG Criteria Output:	**N**	**N**

* A **Relevant Effect** means that the impact of the applicable ESG risk factor has not changed the rating or rating trend on the issuer.
A **Significant Effect** means that the impact of the applicable ESG risk factor has changed the rating or trend on the issuer.

Germany, Federal Republic of: ESG Considerations

December 3, 2021

Environmental

This factor does not affect the ratings assigned to Germany. From a credit perspective, policies relating to each subfactor are generally sound, and the fiscal cost of new investments is managed effectively within the context of Germany's budgetary framework. Recent adjustments to Germany's Climate Action Plan have made targets more ambitious. Compared to 1990 levels of greenhouse gas emissions, Germany now targets a 65% reduction by 2030, 85-90% by 2040, and net zero emissions by 2045. Previously, the goals were a 55% reduction of emissions by 2030 and to reach climate neutrality by 2050. Those previous targets were deemed "Highly Insufficient" by the Climate Action Tracker. DBRS Morningstar will continue to assess the credit impact of new regulatory and policy measures.

Social

This factor does not affect the ratings. Germany's respect for human rights is high, and access to quality healthcare and other basic services is widespread. Germany ranks 11 among the 163 countries assessed in the 2020 Social Progress Index. Germany's economy is highly productive and competitive, ranking seventh out of 141 countries in the World Economic Forum's 2019 Global Competitiveness Index. Low income inequality compared to most advanced economies, according to the OECD, reduces economically disruptive labour or social conflicts.

Governance

This factor does not affect the ratings assigned. Germany has independent and transparent institutions. Demonstrating a high degree of transparency and accountability, German institutions perform well in the World Bank's Worldwide Governance Indicators (WGI). Germany's 2020 percentile rank scores of 94.2 for Voice and Accountability and 91.3 for Rule of Law are very strong.