**Rating-Agentur Expert RA confirmed at 'AAA' the ratings of Germany. The rating outlook is stable.**

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Germany at 'AAA' (Highest level of creditworthiness of the government) in national currency and at 'AAA' (Highest level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- GDP grew at a rate of 2,5% in 2017, better than we anticipated, driven by domestic consumption. Investment also picked up due to an increase in exports. As of the 2Q 2018, growth continued to be solid at 2,3% again propelled by domestic demand to which government expenditure contributed. In the long-term perspective we anticipate growth to decline as a result of lack of skilled labor and aging population;
- Short-term debt levels remain acceptable. As of 1Q 2018, this metric represented 20,5% of total debt and around 19% of GDP;
- Competitiveness, economic development and diversification of the economy remain key strengths of Germany's creditworthiness assessment. As of end-2017, real GDP per capita in PPP terms was USD 50,4 th. Moreover, Germany ranked 5th out of 138 countries in the competitiveness index from the World Economic Forum and 20th out of 190 countries in the Doing Business ranking published by the World Bank in 2017;
- As of August 2018, the harmonized index of consumer prices (HICP) increased by around 1,9% y-o-y driven by hikes in energy and food prices. Overall inflation, however, has eased in the last four months. We anticipate the HICP index to grow at a 1,6% rate by the end of 2018;
- The spread between the 10Y German Bund and the US 10Y bond is negative by around 2,5p.p. This spread has been widening since mid-2017 reflecting the divergence in monetary policies as well as the investor confidence in German government obligations and confirming its status as a safe haven;
- Fiscal discipline continues to be a key strength for Germany's creditworthiness. As a result of the debt brake rule and the government's commitment to the "black zero" budget[1], public finances showed a widening surplus in 2017 at 1,2%. As a consequence of the financial plan for 2022, which includes a commitment to avoid issuing new debt, we do not anticipate the debt stance to change in the mid-term perspective; instead, we expect a well-balanced budget with additional expenditures in education, infrastructure and, mostly, in the social sphere;
- Germany currently enjoys record levels of employment. The unemployment rate continues to decline and stood at 3,4% as of July 2018, 0,4p.p. lower than at the end of 2017. This has caused increased domestic demand and, thus, higher inflation levels. Going forward, we expect this rate to remain stable as capacity utilization remains high;
- Despite low profitability due to low interest rates and high operating costs as compared

[1] Germany's balanced fiscal budget is referred to as "black zero" (*schwarze Null*) budget among Germans.

to other European banks, the banking sector remains strong as the NPLs to total loans ratio was around 1,9% in 2017. Moreover, funding and liquidity remain solid;

- Highly developed national stock market (Deutsche Börse) with a market capitalization to GDP ratio at 61,5% in 2017.

Restricting factors:

- Gross government debt continued to decline and is set to be below the 60% Maastricht criteria threshold by 2019. We anticipate debt in 2018 to be around 60% and continue to go down to 55,7% of GDP by 2019. The revised figure of debt stood at 142% of budget revenues and 64,1% of GDP in 2017, lower than peers[2]. We do not expect further debt issuance by the current administration which, combined with slower but still solid economic growth and improving fiscal stance, will keep the debt metric in a declining path;
- A lingering concern for the government is the aging population and low birth rates in Germany as pension and healthcare spending is projected to grow significantly. According to the 2018 Aging Report from the European Commission, age related spending is expected to increase by 4,2p.p. by 2070, well above the EU average of 1,7p.p. However, recent reforms have slightly eased pressure on this subject temporarily, especially when it relates to short- to mid-term pension expenditure growth.

Negative factors:

- The dynamics of assets and domestic credit in the banking sector continue to be negative as the banks' assets to GDP ratio declined by 11,6p.p. in 2017 down to 236,3% of GDP. Moreover, domestic credit was reduced by 6,5p.p. down to 127% of GDP, continuing its decline since 2015. However, domestic household and corporate credit continued to increase at a stable pace. As of April 2018, y-o-y credit growth of household and corporations was around 5% and 2% respectively;
- The share of state owned banks in Germany is quite high (assets from *Landesbanken* and *Sparkassen* account for around 26,6% of the total sector) augmenting the contingent liabilities of the government. However, in a scenario where the German government would have to intervene to cover potential liabilities, we consider the authorities to have enough buffers to absorb the shock;
- The average banks' capital to assets ratio remained low at 6,3% in 2017. However, regulatory capitalization levels remain favorable.

Support factors:

- Germany participates and is a key member of the European Union (very strong support factor);
- The country has an extremely strong financial system which affects other countries (very strong support factor);
- The country has a strong, stable and important reserve currency (Euro) (moderately weak support factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to a downgrade:

- An unexpected and prolonged deterioration of public finances leading to material increase of the gross government debt as well as short-term obligations;
- Strong negative spillover effects in the German economy as a result of unfavorable dynamics abroad (protectionist measures or emerging market crisis, for instance).

[2] Peers include Austria, Japan, UK and USA.

"Germany's ratings at 'AAA' remain underpinned by a solid fiscal discipline, which has translated in lower debt levels and increasing budget surpluses, stable GDP growth combined with record employment levels, a strong external position and a healthy, albeit underperforming, banking sector. Moreover, Germany remains one of the most developed and competitive countries in the world.

Despite the extremely strong position of the economy, the government remains exposed to potential contingent liabilities as it owns around 26% of the banking sector. Additionally, population ageing remains a concern for the long-term stability of public finances. Finally, given the protectionist rhetoric of trading partners, as well as the recent emerging market issues, could create negative spillover effects for Germany as the country's economy and financial sector are highly interconnected worldwide." – Clarified Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH.

Responsible expert: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA

Reviewer: Marko Denic, Rating Analyst of Rating-Agentur Expert RA

Research report on Germany is available at:

https://raexpert.eu/reports/Research_report_Germany_07.09.2018.pdf

Next scheduled rating publication: TBD in December 2018.

For further information contact:

**Rating-Agentur Expert RA GmbH**
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

| Date | Review reason | SGC | | Outlook | |
|---|---|---|---|---|---|
| | | National currency | Foreign currency | National currency | Foreign currency |
| 09.03.2018 | Scheduled revision of both types of ratings | AAA | AAA | NA | NA |
| 15.09.2017 | Scheduled revision of both types of ratings | AAA | AAA | NA | NA |
| 17.03.2017 | Scheduled revision of both types of ratings | AAA | AAA | NA | NA |
| 23.09.2016 | Scheduled revision of both types of ratings | AAA | AAA | NA | NA |
| 15.04.2016 | First assignment of both types of ratings for the country | AAA | AAA | NA | NA |

**Minute's summary**

The rating committee for Germany was held on 5 September 2018. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings – Full Public Version (from May 2018) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.pdf. Descriptions and definitions of all rating categories can be found under the following link: http://raexpert.eu/sovereign.php under the "Rating scale" section. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

**These ratings are unsolicited. The rated entity did not participate in the rating process.**

Main sources of information: International Monetary Fund, World Bank, World Federation of Exchanges, World Economic Forum, Doing Business, United Nations, German Bundesbank, European Central Bank, Ministry of Finance of Germany, Deutsche Börse, Destatis, Cbonds.

**Limits of the Credit Rating**

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

**Regulatory use**

SGC ratings can be used for regulatory purposes according to the ESMA definition.

**Conflict of interest**

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

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**Office responsible for preparing the rating**

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

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The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.