



Subnational Debt 2024: Germany

Subdued fiscal performance suggests borrowing will rebound

S&P Global
Ratings

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This report does not constitute a rating action

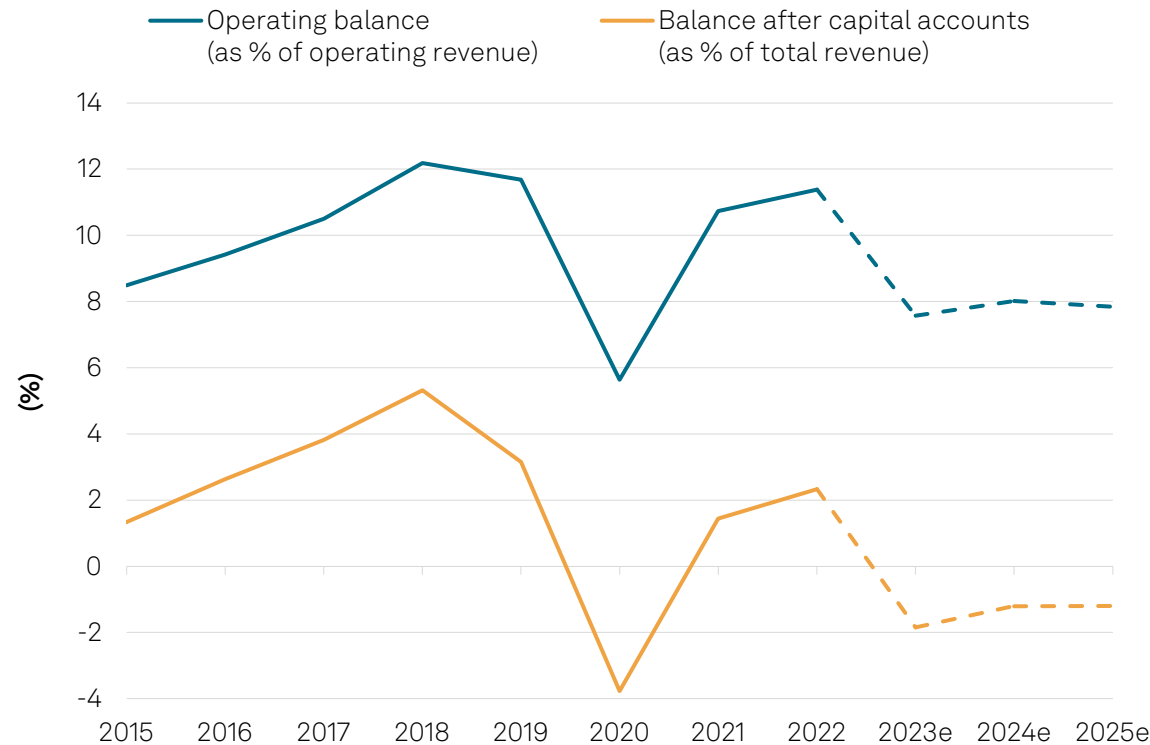
Key Takeaways

- German local and regional governments (LRGs) face deteriorating macroeconomic and fiscal environments, which combined with debt regulations that permit only limited deficits could leave LRGs' capital expenditure growth at below inflation.
- We forecast German states and municipalities will borrow €126 billion in 2024. About 45% of that will likely be funded with bonds, which are almost exclusively the preserve of the states, suggesting a material resurgence in annual bond issuance following lows in 2022.
- The effect of recently higher yields on LRGs' interest costs are mitigated by their mostly fixed rate funding and balanced maturities, though significant aggregate debt burdens mean increasing yields are materially relevant to overall budgets.
- German LRGs' revenue and expenditure structure exposes them to certain uncontrollable risks, including inflation of major costs and subdued economic growth that can weigh on shared taxes.

Net Borrowing Needs Arise From Subdued Fiscal Performance

Cost inflation, tax breaks, and limited economic growth will likely weigh on German LRGs' fiscal results

Balances of German LRGs



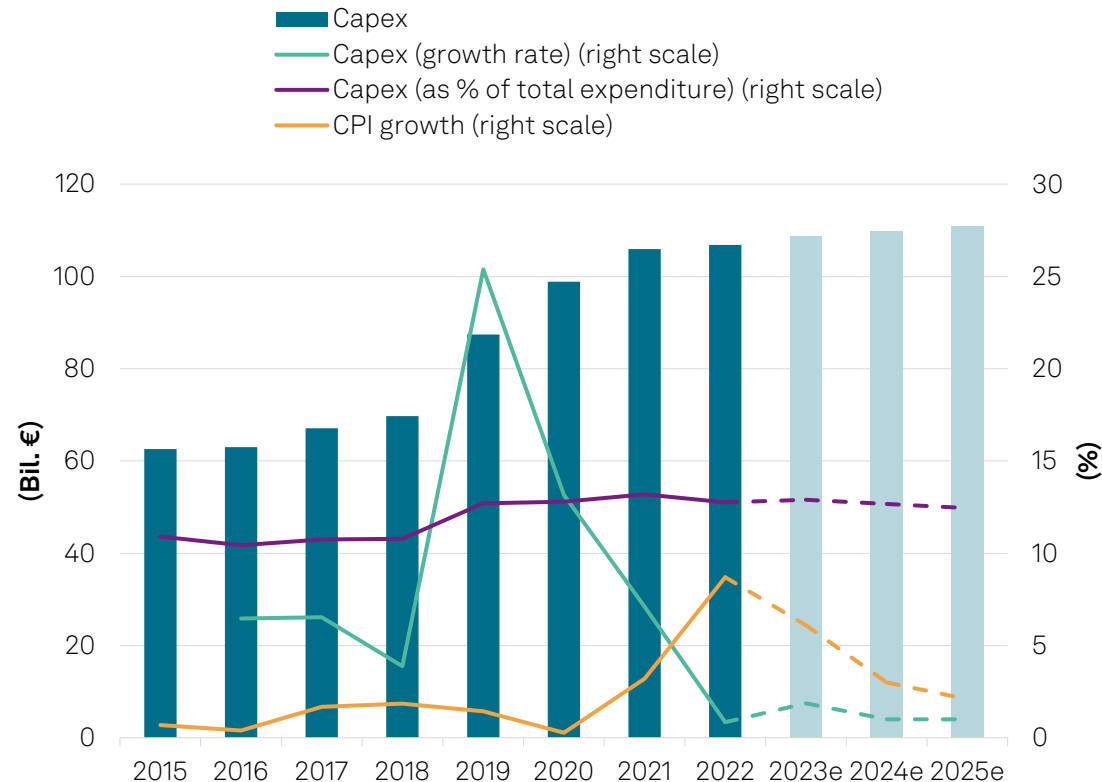
e--Estimate. Sources: Federal Statistics Office, S&P Global Ratings.

- For German LRGs, we forecast small deficits over 2023-2025, and hence a (limited) net borrowing need:
 - 2023 was a no-growth year for tax revenue, due to tax breaks under federal stimulus measures
 - From 2024, cost inflation will bite, particularly due to recent public sector wage deals
 - Weak economic growth is expected, at least in 2024
- The country's debt brake, re-applied since 2023, promotes discipline but does not fully prevent deficits after capital expenditure in cash terms:
 - Use of reserves/provisions, business cycle exceptions, and "creative accounting" provide leeway for limited cash deficits at state level
 - Cities/municipalities are not subject to the debt brake rule

Capital Expenditure Remains Nominally Strong, But Trails Inflation

Compliance with debt brake rules and capacity constraints could limit investment spending growth

Capital expenditure of German LRGs



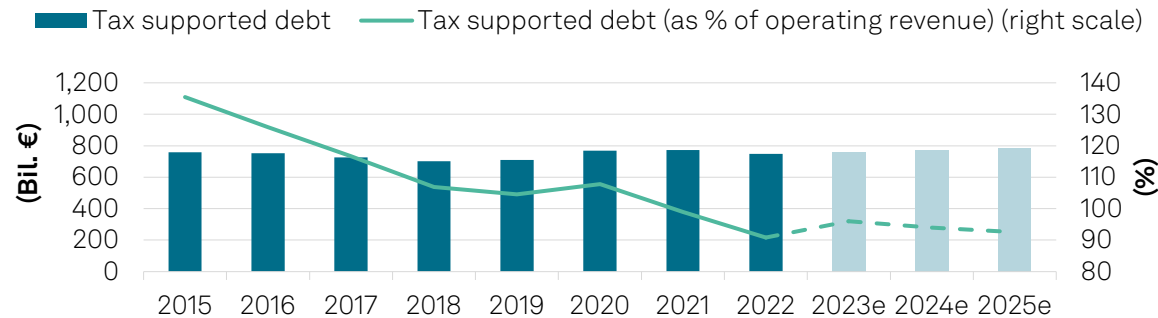
Capex--Capital expenditure. CPI--Consumer price index. Sources: Federal Statistics Office, S&P Global Ratings.

- We expect German LRGs' capital expenditure (capex) to remain above 12% of total expenditure and--unlike in many other countries--not fall materially below levels reached during the pandemic
- We think capital spending growth resumed in 2023, but (at an estimated rate of below 2%) likely fell short of inflation
- Although capex is an area of political focus, we expect its growth to remain negative in real terms, reflecting:
 - Constraints imposed by debt brake compliance, meaning--as suggested in political debates--fiscally weaker entities restrict investment to meet the zero-deficit target
 - Capacity constraints (administrative, planning, contractors, etc.) in fiscally stronger entities

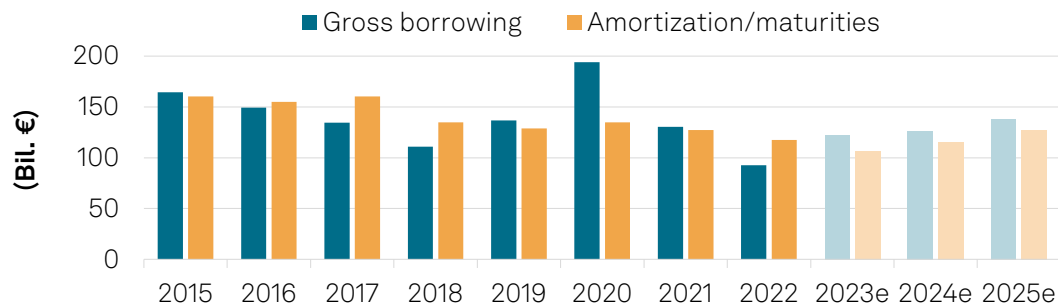
Despite Net Borrowing, We Anticipate A Declining Relative Debt Burden

Revenue is expected to outgrow increased debt

Tax supported debt of German LRGs



Gross borrowing and repayments by German LRGs



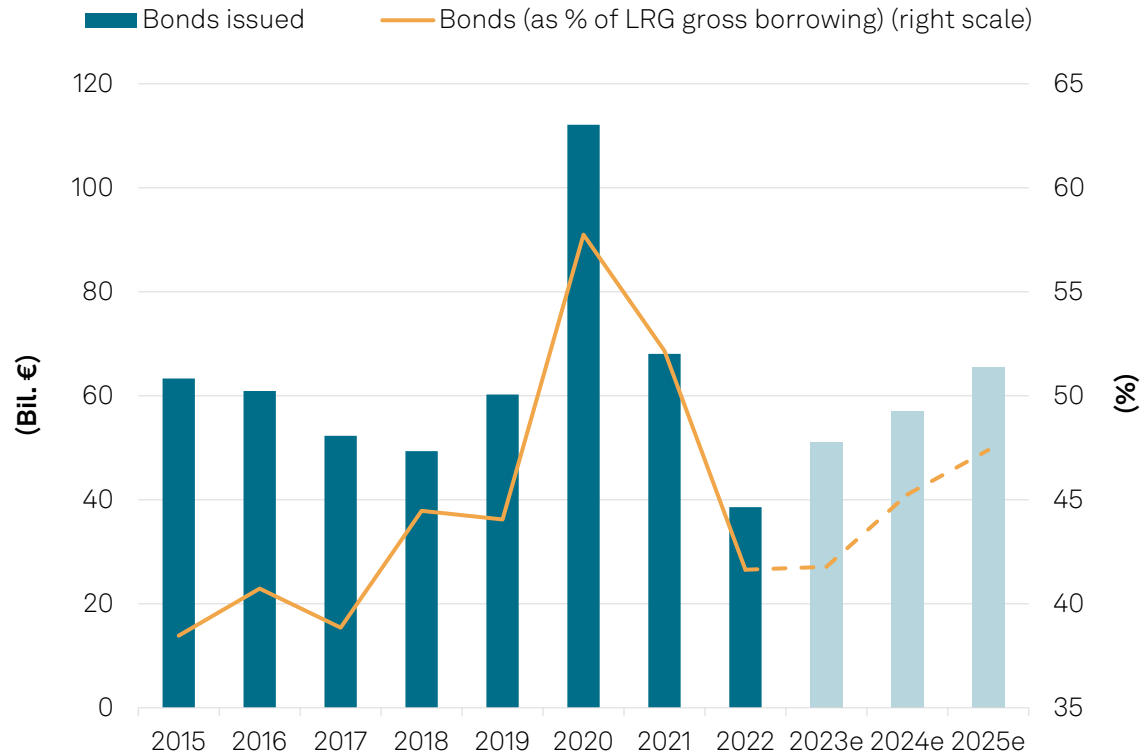
e--Estimate. Sources: Federal Statistics Office, S&P Global Ratings.

- We expect outstanding German LRG debt will reach almost €784 billion by 2025:
 - Anticipated annual gross borrowing of €122 billion to €138 billion during 2023-2025, and repayments of €107 billion to €128 billion
 - Expected annual net borrowing of €10 billion to €15 billion over 2023-2025 represents a reversal of the repayment of €25 billion of net debt in 2022
- Despite net new borrowing, we expect the tax-supported debt ratio to further decline, albeit slightly. That:
 - Reflects stronger growth in LRGs' nominal revenue (denominator) than in debt (numerator)
 - Signals the sustainability of German LRGs' current revenue-expenditure balance, but raises ongoing questions regarding the economic adequacy of capital expenditure volumes

Annual Bond Issue Volumes Likely To Rebound Toward €60 Billion

Maturities and net new borrowing needs indicate growth in new issue volumes

Bond issuance by German LRGs



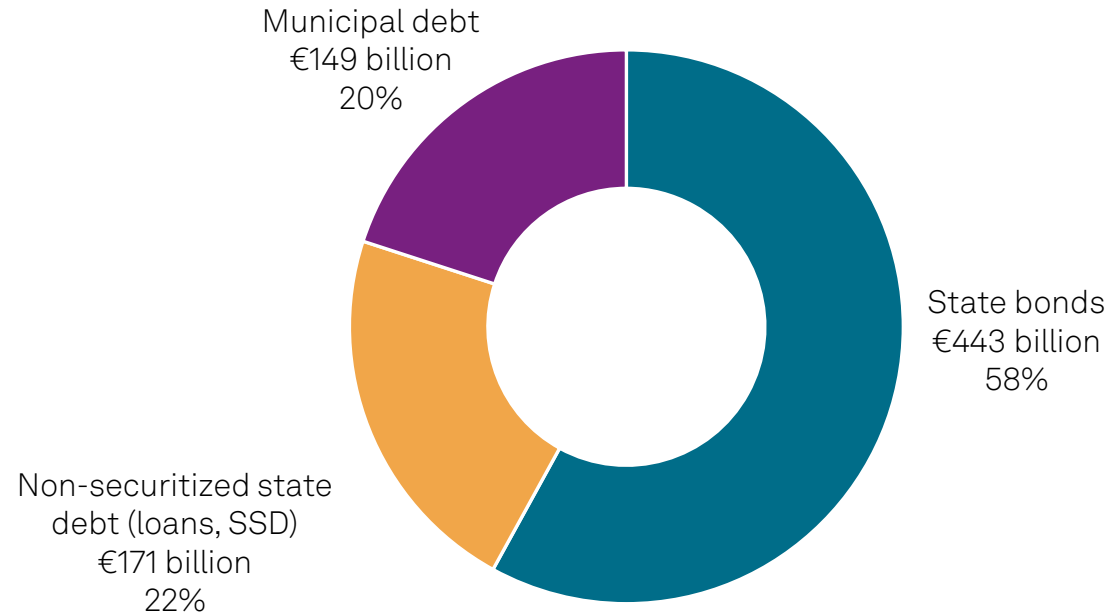
e--Estimate. Sources: Federal Statistics Office, S&P Global Ratings.

- German LRG-issued bonds amounted to a total €443 billion by the end of 2023, equal to about 58% of LRG's total outstanding debt
- We expect a steady increase in new bond issuance to above €60 billion by 2025, up from the recent low in 2022:
 - This would lift bond's share of annual gross borrowing back toward 50%
- Our prediction reflects:
 - Net new borrowing needs implied by the anticipated deficits
 - And more importantly, increased bond maturities that will need refinancing
- Bond financing remains almost exclusively limited to German states, with almost no municipal issuance
- Green/social bonds will play an increasingly prominent role

German LRG Debt Split And Largest Bond Issuers

North Rhine-Westphalia (NRW) continues to lead Lower Saxony and Berlin

German LRG debt split



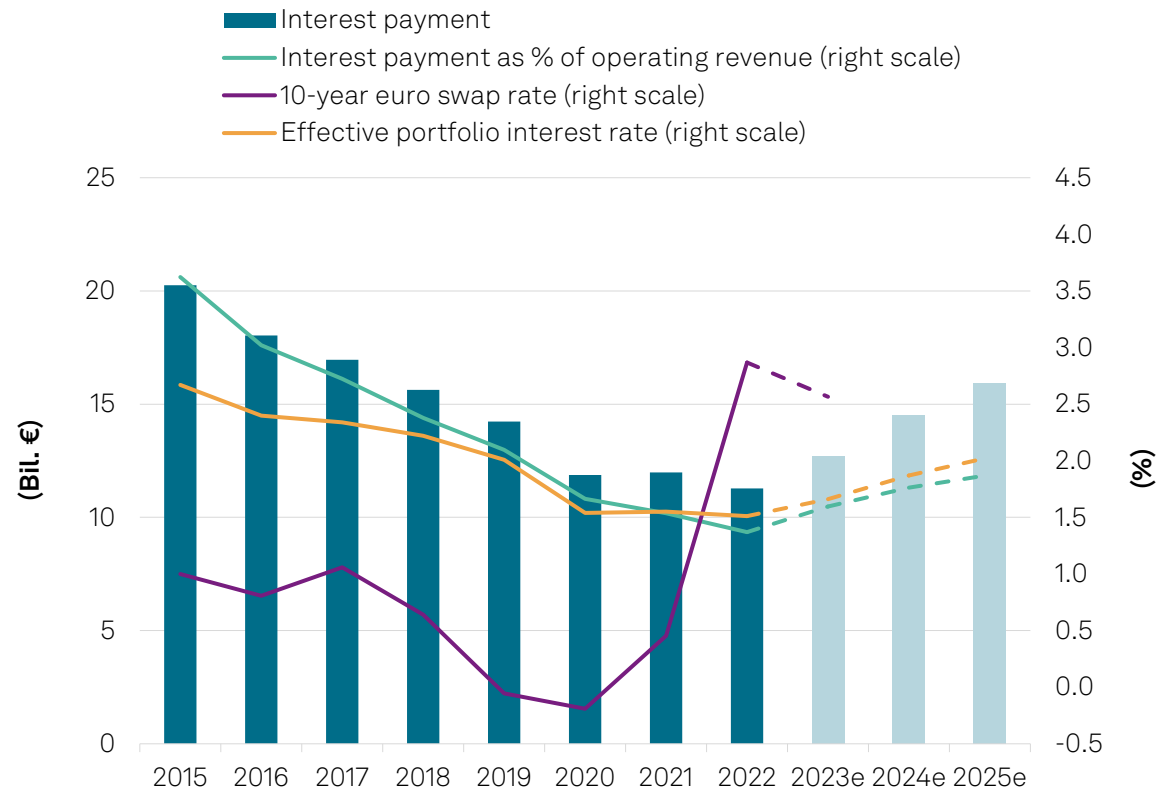
SSD--"Schuldschein" loan certificate. Sources: Federal Statistics Office, S&P Global Ratings.

Largest German LRG bond issuers		
NRW	Bonds outstanding as of end-2023: Bond issuance in 2023: Announced issuance volume 2024: S&P Global Ratings rating:	€131 billion €12.6 billion €10 billion AA/Stable/A-1+
Lower Saxony	Bonds outstanding as of end-2023: Bond issuance in 2023: Announced issuance volume 2024: S&P Global Ratings rating:	€47 billion €3.8 billion Not available Not rated
Berlin	Bonds outstanding as of end-2023: Bond issuance in 2023: Announced issuance volume 2024: S&P Global Ratings rating:	€45 billion €5.5 billion €9.6 billion Not rated
Hesse	Bonds outstanding as of end-2023: Bond issuance in 2023: Announced issuance volume 2024: S&P Global Ratings rating:	€34 billion €6.3 billion €7 billion AA+/Stable/A-1+
Rhineland-Palatinate	Bonds outstanding as of end-2023: Bond issuance in 2023: Announced issuance volume 2024: S&P Global Ratings rating:	€21 billion €4.1 billion Not available Not rated

LRG Interest Costs Will Rise As Cheaper Debt Is Refinanced

Long-term, fixed-rate debt slows repricing

Interest cost of German LRGs

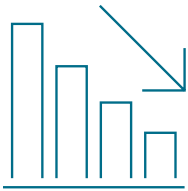


e--Estimate. Sources: Federal Statistics Office, S&P Global Ratings.

- German LRGs' effective portfolio interest rate is expected to increase gradually, from 1.5% in 2022 to 2.0% by 2025
- German LRGs benefit from:
 - A high share of fixed rate debt (only about 7% of obligations are variable rate)
 - A balanced maturity profile (outstanding bonds had a weighted average life of 11 years as of end-2023)
- Most of the prolific issuers significantly extended their duration when rates were low:
 - For example, NRW issued €13 billion of bonds maturing beyond 2070 during 2018-2023
- However, a high average debt burden (at 96% of operating revenue) means German LRGs are more exposed to yield swings than less indebted peers, e.g., LRGs in Switzerland

Identifiable Key Risks

Revenue and expenditure structure exposes German LRGs to certain uncontrollable risks



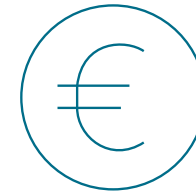
General economic trend

- Due to shared taxes being responsible for about 2/3 of revenue, German LRGs are exposed to general economic trends
- Subdued economic activity and growth almost instantaneously translate into lower taxes
- Any new economic stimulus measures will intensify pressure on local budgets, as was seen in 2023



Uncontrollable cost drivers

- Expenditure will grow strongly as inflation creeps into budgets (with a time delay), especially for wage bills, but also in the form of goods and services costs
- Uncontrollable cost inflation (for example rising spending needs for refugees, education and digital transformation of governments) also threaten to push costs markedly higher



Capital spending

- Debt brake rules limit investment headroom for the state tier of German government, with similar restrictions for municipalities
- Constraints on spending restricts the numbers of investment projects and extends the time-horizon for project completion
- These constraints keep infrastructure investment at suboptimal levels and ensures ongoing needs remain high

Related Research

- [Subnational Debt 2024: Fiscal Policy Differences Influence Borrowing In Developed Markets](#), March 4, 2024
- [Subnational Debt 2024: France, Adaptability Will Remain Key Amid Sluggish Growth](#), March 4, 2024
- [Subnational Debt 2024: Spain \(Debt Absorption Scenarios\): All could benefit, with some more than others](#), March 4, 2024
- [Subnational Debt 2024: Australian States' Debt Rift Deepens](#), Feb. 29, 2024
- [Subnational Debt 2024: Canadian Local And Regional Governments Are Running Fast To Stay In Place](#), Feb. 29, 2024
- [Subnational Debt 2024: Chinese Governments Reach Their Limits; Other Emerging Markets Taper Borrowing](#), Feb. 29, 2024
- [Subnational Debt 2024: Focus on debt sustainability](#), Feb. 29, 2024
- [Subnational Debt 2024: Germany, Subdued Fiscal Performance Suggests Borrowing Will Rebound](#), Feb. 29, 2024
- [Subnational Debt 2024: Global LRGs Can Handle Rising Interest Expenses](#), Feb. 29, 2024
- [Subnational Debt 2024: Infrastructure Spending Succumbs To Economic Slowdown](#), Feb. 29, 2024
- [Subnational Debt 2024: Spain: Lower borrowings, but bond issuances recover](#), Feb. 29, 2024
- [Subnational Debt 2024: Switzerland, Resilient Budget Surpluses Should Enable Further Deleveraging](#), Feb. 29, 2024
- [China City Governments Risk Falling Into A Debt Trap](#), Feb. 20, 2024

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