

# Land of Saxony-Anhalt

## Rating Report



### Credit strengths

- Integrated institutional framework, leading to close alignment with German federal government
- Sound budgetary management and performance
- Assured liquidity, excellent market access, conservative debt management
- Low contingent liability risks

### Credit challenges

- High debt burden
- Limited revenue flexibility
- Moderate expenditure flexibility, spending pressures
- Modest socio-economic profile

### Ratings and Outlook

#### Foreign & local currency

Long-term issuer rating	AAA/Stable
Senior unsecured debt	AAA/Stable
Short-term issuer rating	S-1+/Stable

### Lead Analyst

Julian Zimmermann  
 +49 69 6677389-89  
[j.zimmermann@scoperatings.com](mailto:j.zimmermann@scoperatings.com)

### Team Leader

Alvise Lennkh-Yunus  
 +49 69 6677389-85  
[a.lennkh@scoperatings.com](mailto:a.lennkh@scoperatings.com)

### Rating rationale and Outlook

The AAA/Stable rating of the Land of Saxony-Anhalt (Saxony-Anhalt) is driven by:

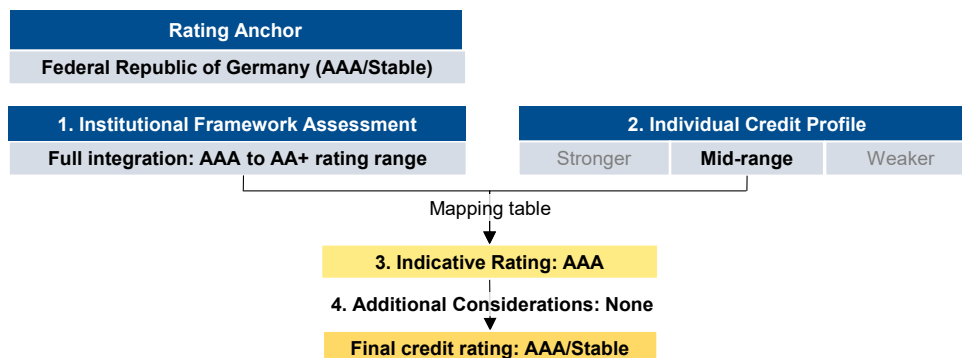
- **A highly integrated Institutional Framework**, resulting in a close alignment of German federal states' creditworthiness with the German central government's **AAA/Stable** rating. Key considerations are a strong revenue equalisation system and the federal solidarity principle, among others.

- **A 'mid-range' Individual Credit Profile:**

Saxony-Anhalt's credit strengths are: i) sound budgetary management, with operating performance benefitting from sizeable and predictable intergovernmental transfers; ii) strong debt and liquidity management, including via a commercial paper programme, assured access to external liquidity, and excellent capital market access and funding conditions; and iii) low contingent liability risks.

Challenges are: i) a high debt level; ii) limited revenue flexibility and moderate expenditure flexibility coupled with rising spending pressures; and iii) a modest socio-economic profile vis-à-vis peers.

### Our approach to rating Saxony-Anhalt



Note: For further details, please see Scope's [Sub-sovereigns Rating Methodology](#). Source: Scope Ratings

### Positive rating-change drivers

- N/A

### Negative rating-change drivers

- Downgrade of Germany's sovereign rating
- Changes in the institutional framework, resulting in notably weaker support
- Deterioration of individual credit profile

### Scope Ratings GmbH

Neue Mainzer Straße 66-68  
 60311 Frankfurt am Main  
 Phone +49 69 6677389-0

### Headquarters

Lennéstraße 5  
 10785 Berlin

Phone +49 30 27891-0  
 Fax +49 30 27891-100

[info@scoperatings.com](mailto:info@scoperatings.com)  
[www.scoperatings.com](http://www.scoperatings.com)



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### Federal framework results in close rating alignment...

## Institutional framework

German Länder<sup>1</sup> benefit from a mature, highly predictable and integrated institutional framework. The key elements are: i) a strongly interconnected revenue equalisation mechanism enshrined in the constitution; ii) strict fiscal rules and monitoring, iii) wide-ranging participation and veto-rights of the federal states in the national legislation; iv) equal entitlement of federal states regarding negotiations on federal reforms; and v) a solidarity principle that ensures extraordinary system support during budgetary emergencies.

**The federal system under which the Länder operate is the most integrated among the European sub-sovereign systems we cover.** This is driven by our assessments of 'full integration' for extraordinary support and bailout practices, ordinary budgetary support and fiscal equalisation, fiscal rules and oversight, and revenue and spending powers. We assess funding practices as 'medium integration' (see [Appendix I](#) for an overview).

### ...with distance of up to one notch from sovereign rating.

The framework assessment for German Länder results in an **indicative downward rating adjustment of up to one notch** from Germany's AAA/Stable rating.

### Strong solidarity principle ensures extraordinary support

## Extraordinary support and bail-out practices

Our framework assessment acknowledges a record of extraordinary financial support. Länder have been granted exceptional financial support from the federal government in five instances: Bremen (1992, 2006), Saarland (1992, 2005) and Berlin (2002). The court approved claims on the grounds of the solidarity principle, or *Bundestreueprinzip*, under which the Länder and the federal government are required to support each other in the event of a budgetary emergency. A claim by Berlin was denied in 2006, with the court arguing that the city-state was not in an extreme budgetary situation. However, the judges noted that federal emergency support would still be possible as a last resort if the budget and/or debt situation were later assessed as extreme. We consider the *Bundestreueprinzip* to be an implicit bail-out rule, as it requires the provision of federal support in times of budgetary stress.

### Federal government as shock absorber during recent crises

More recently, the federal government confirmed its role as a primary countercyclical shock absorber during the Covid-19 and energy crises in 2020-2023. Over these years, the federal government financed most anti-crisis measures and direct grants to the Länder to mitigate the impact on their finances. This led to federal budget deficits of an average 3.3% of GDP over 2020-2022, compared with an average deficit of the Länder of 0.14% over the same period.

### Comprehensive fiscal equalisation system

## Ordinary budgetary support and fiscal equalisation

The federal financial equalisation system strongly aligns different fiscal capacities across the Länder. A reformed equalisation system took effect in 2020, with horizontal distribution occurring via deductions and top-ups to collected VAT, as well as vertical transfers from the federal government. The net effect of the system change is positive for all Länder as contributions from the federal government are greater under the reformed system.

### Saxony-Anhalt is a net beneficiary of the system

Saxony-Anhalt is a net beneficiary with total transfers of EUR 3.4bn in 2022, or 26% of operating revenue. These stable and predictable transfers significantly strengthen Saxony-Anhalt's credit profile.

<sup>1</sup> We use the term 'Land' (or collectively 'Länder') and 'state' interchangeably to refer to German federal states.

### Autonomous borrowing, access to shared liquidity

## Funding practices

Länder governments have broad autonomy in their funding choices. There is no use of sovereign on-lending, and Länder can decide autonomously on their borrowing programmes within the framework of the debt brake. Short-term liquidity is available via access to shared liquidity among the Länder and the federal government, essentially eliminating liquidity risk. Basel III risk-weights for Länder debt securities are aligned at 0% with the central government. The Länder have a history of joint bond issuance, having issued such instruments on 63 occasions, although not all of the 16 Länder participated. Saxony-Anhalt has not participated in any of the past issues.

### Debt brake anchors borrowing; stability council conducts oversight

## Fiscal rules and oversight

Since 2020, the Länder have to comply with debt brakes under which they cannot run structural financing deficits unless, for example, hit by a severe economic downturn or a natural disaster.<sup>2</sup> The federal debt brake caps the structural annual deficit of the central government at 0.35% of GDP. The German federal parliament used the emergency clause of the debt brake in 2020-2023 in response to the Covid-19 and energy crises. Separately, Saxony-Anhalt invoked the safeguard clause of its debt brake for 2020-2024 to implement support measures and credit authorisations to mitigate the impact of Covid-19. Borrowing under safeguard clauses comes with mandatory redemption rules.

Compliance with the debt brake and Länder finances are monitored by the Stability Council. The Council was established in 2010 to monitor restructuring programmes and compliance with budgetary targets and comprises the finance ministers of each Land and the federal ministers of finance and economic affairs. If the Council determines that a Land is threatened with a budgetary emergency, it agrees on a restructuring programme with the affected authority.

### 15 November 2023 constitutional court ruling with implications...

In late 2023, Germany's constitutional court ruled the Second Supplementary Budget Act 2021 of the federal government as unconstitutional and thus void. Crucially, the ruling also gives the constitutional court's broader interpretation of emergency budgetary practices under debt brake rules widely implemented by the federal and state governments since 2020. In the Budget Act, the federal government retroactively reallocated and repurposed funds initially raised via the emergency clause of the debt brake to address the Covid-19 crisis to its climate and transition fund for spending over coming years. The ruling has implications for Länder governments, as they employed similar budgetary practices of using emergency credit authorisations in a given year for budgetary reserves for spending in subsequent years.

### ... including for Saxony-Anhalt, which reacted promptly.

Saxony-Anhalt was also affected as it had set up a Covid-19 special fund of EUR 2bn in 2021, targeted at enhancing the state's long-term social resilience. The fund's spending between 2022 and 2027 was initially planned to be funded via a reserve using funds raised via emergency credit authorisations in 2021.

### Saxony-Anhalt's Covid-19 special fund envelope unchanged at EUR 2bn

To ensure the legal basis of its special fund considering the constitutional court ruling, Saxony-Anhalt passed a supplementary budget for 2023 and ensured its budgetary act for 2024 is in line with requirements to declare a continued emergency budgetary situation each year spending under the special fund takes place. This budgetary response will not lead to higher borrowing, as the special fund's aggregate envelope remains unchanged at EUR 2bn. Both budget laws include annual emergency credit

<sup>2</sup> The debt brake is a legal framework that prohibits structural deficits for the Länder from 2020 onwards; article 109 (3) of the Basic Law stipulates that the Länder may incur deficits in a case of, for example, a recession or a natural disaster provided they pass respective legislation at the state level.

authorisations for spending under its Covid-19 special fund. The existing reserve of unspent funds raised in 2021 for the special fund will be unwound in 2024.

### Revenue and spending powers

The Länder and the federal government share a taxation authority and jointly decide on rates and revenue distribution for high-revenue common taxes (income and VAT). The latest reform of federal financial relations (in 2017) took effect in 2020 and resulted in a higher share of VAT revenue being distributed among the Länder. The VAT distribution fully compensates for the variation in taxing powers, replacing the previous process of horizontal payments between the Länder. Alongside common taxes, the central government and the Länder have separate taxation authorities for lower revenue-generating taxes.

Under the reform agreed in 2017, the Länder have assigned limited executive and legislative rights to the central government in certain policy areas, including physical and digital infrastructure and the higher education system, in return for higher payments from the equalisation system. In line with earlier reforms (*Föderalismusreformen II*), we observe that the higher the share of common national legislation (*konkurrierende Gesetzgebung*), the more integrated the system becomes.

### Political coherence and multi-level governance

The German federal system is very predictable and supportive. Major reforms are discussed and agreed upon well in advance and in consultation with the Länder, which can directly influence national policymaking via the upper house of parliament.

### Individual credit profile (ICP)

We assess Saxony-Anhalt's ICP as 'mid-range' among German Länder. This places the Land's indicative rating at AAA, given our assessment of very close integration with the federal government and our mapping table, see [Appendix II](#).

Saxony-Anhalt's individual credit strengths are: i) sound budgetary management, with operating performance benefitting from sizeable and predictable intergovernmental transfers; ii) strong debt and liquidity management, including via a commercial paper programme, assured access to external liquidity, and excellent capital market access and funding conditions; and iii) low contingent liability risks, with a well-funded pension fund with regular annual transfers reducing risks from uncovered pension liabilities.

Challenges are: i) a high debt level compared to peers; ii) limited revenue flexibility and moderate expenditure flexibility coupled with spending pressures; and iii) a modest socio-economic profile vis-à-vis peers.

Over 2020-2021, the Covid-19 pandemic led to moderately higher debt and a temporary budgetary deterioration due to revenue losses and additional expenditure. Budgetary performance recovered strongly in 2022, allowing the state to enter 2023 with budgetary reserves. However, we expect these reserves will be exhausted in the near-term, as tax revenue growth has slowed materially in 2023 and as operating and capital expenditure pressures persist in the near-to-medium term.

While we identify similar operating budgetary pressures for all German Länder, Saxony-Anhalt's rising capital expenditure also includes the planned construction of Intel's chip factory near the state's capital Magdeburg. This EUR 30bn project, of which around EUR 10bn is to be subsidised by the federal government, will also require significant investments by the Land into its municipal infrastructure.

Shared tax authority with the federal government

Federal reforms strengthen political coherence

ICP of 'mid-range' strength, leading to indicative AAA rating

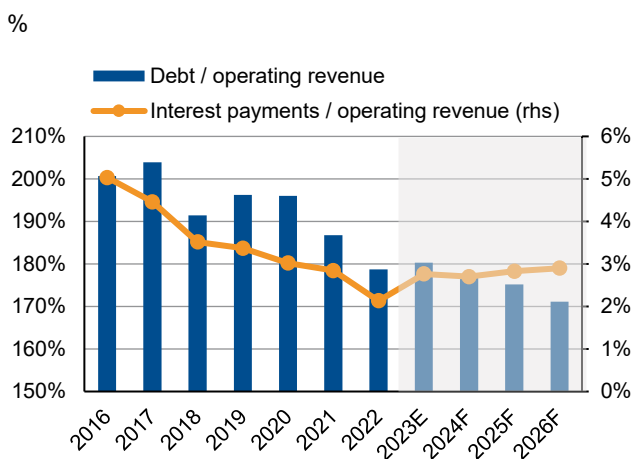
## Debt burden and liquidity profile

Relatively high debt, consolidation path before 2019

Saxony-Anhalt's debt is high compared to peers. The Land's debt of around EUR 23bn amounted to 180% of operating revenue at YE 2022 (see **Figure 1**). This is the fourth-highest ratio among the Länder, and well-above the sector-wide average of 120% in 2022. We expect the debt to operating revenue ratio to decline gradually to around 171% by 2026, as nominal debt should rise only moderately and operating revenue is expected to grow at an annual rate of 2.6% over 2024-2026.

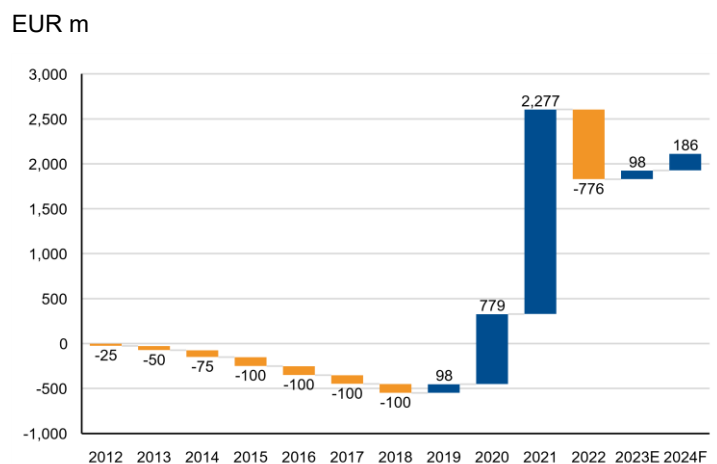
Since 2016, Saxony-Anhalt's debt has declined from around 201% of operating revenue (EUR 20.6bn), in line with the state's track record of budgetary consolidation with seven consecutive years up to 2019 of negative net borrowing of up to EUR -100m (see **Figure 2**). In 2019, the recapitalisation of NordLB (where Saxony-Anhalt holds a 6% stake) led to net borrowing of around EUR 100m.

**Figure 1: Debt and interest burden**



Source: Land of Saxony-Anhalt, Destatis, Scope Ratings

**Figure 2: Net borrowing**



Source: Land of Saxony-Anhalt, Destatis, Scope Ratings

Net borrowing in 2020-2021 due to Covid-19

In 2020 and 2021, the Land's net borrowing further increased to around EUR 800m and EUR 2.3bn, respectively, driven by the Covid-19 crisis. In 2020, the state took on net borrowing to counteract the adverse impact of the pandemic on tax revenue and to compensate for higher spending. In 2021, net borrowing under the debt brake emergency provision was mostly used for the Covid-19 special fund.

Strong 2022 with debt redemptions

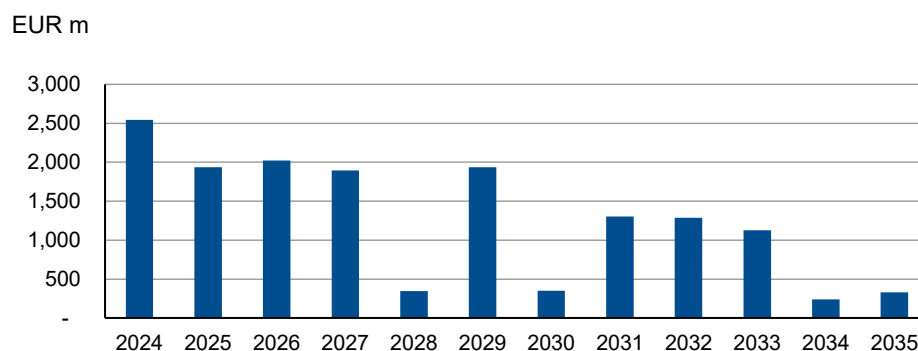
In 2022, the state's strong operating budgetary performance allowed it to redeem EUR 776m of debt (EUR 25m incurred under debt brake emergency provisions and EUR 751m under the cyclical component).

Debt burden should remain broadly stable until 2026

For 2023, we expect the Land's debt burden to remain broadly stable, while existing budgetary reserves will likely be used to lower the need for net borrowing. Over the projection horizon to 2026, we expect the debt burden to increase moderately in nominal terms, from an expected EUR 23.0bn in 2023 to around EUR 23.6bn at YE 2026. Due to rising operating revenue, the debt to operating revenue ratio is projected to decline by around 9pps to 171% in 2026.

Conservative debt management, pro-active funding approach

Risks associated with the relatively high debt stock are mitigated by conservative debt management and a low-risk debt profile. Debt service amounts to around EUR 2.0-2.5bn per year, or 10-15% of the outstanding debt stock, and has been declining in recent years in line with falling interest payments and a long average maturity of debt. The debt redemption profile is smooth over the next four years, with average annual redemptions at around EUR 2bn (see **Figure 3**, next page).

**Figure 3: Debt profile to 2035**

Source: Land of Saxony-Anhalt, Scope Ratings

#### Well managed interest-rate and foreign-currency risks

Saxony-Anhalt's proactive debt management limits maturity, foreign-currency and interest-rate risks, while securing favourable funding conditions and lower net interest payments for the state. The average maturity of capital market debt is 8.9 years. Saxony-Anhalt maintains a market presence in the USD and GBP markets, although the main funding currency is the euro with around 97% of debt outstanding denominated in EUR. Saxony-Anhalt employs derivatives to hedge its foreign-currency and interest-rate risk, such that after hedging, exposure to these risks is minimal. Overall, the need for hedging reduced in recent years due to the Land's higher issuance of EUR-denominated, fixed-rate benchmark bonds, which made up around 45% of total issuance in 2022, up from around 25% in 2017-2019.

#### First social bond issued in 2023

Further, the Land broadened its capital market presence by issuing its first social bond of EUR 500m in 2023, with proceeds of the issue funding the Land's Covid-19 special fund and therefore its longer-term social resilience. 63 measures are to be funded from 2022 to 2027, including the modernisation of hospitals, educational and digitalisation investments to compensate for educational losses during the pandemic. We view the social bond issuance as credit positive, as it widened the Land's investor base.

#### Favourable funding conditions, low interest payment burden

Saxony-Anhalt's interest payments are low as a consequence of proactive debt management and the safe-haven status of the German Länder. The implicit cost of outstanding debt was 1.2% in 2022. Interest payments declined to 2.1% of operating revenue in 2022, from 5% in 2016, raising financial flexibility (see **Figure 1**). We expect the Land's interest payments to increase in 2023 and coming years due to the overall tightening of financing conditions in the euro area, but to remain moderate and below 3% of operating revenue.

#### Assured liquidity, commercial paper programme as unique feature

In line with all German Länder, we view liquidity management as sound due to comprehensive inter-year cash planning and the availability of numerous sources of liquidity, as well as available cash buffers. Between January and September 2023, the Land's average cash balance stood at around EUR 2bn.

One differentiating, unique feature among German Länder is Saxony-Anhalt's commercial paper programme with an envelope of EUR 2bn, raising its short-term financing flexibility.

Cash flows, especially inflows, are prone to seasonal variability driven by the tax calendar. Additional continued access to liquidity to bridge intraday needs, if required, is available through credit facilities from major financial institutions. An additional source of liquidity is also provided by commercial cash transactions between the German Länder, which lend excess liquidity to each other. In combination with excellent market access, the risk of liquidity shortages is negligible.



### Low contingent liability risks

We assess the level of Saxony-Anhalt's contingent liability risks as low. This is due to: i) the low level and low-risk nature of contractual guarantees; ii) limited contingency risk stemming from its shareholdings; and iii) a relatively smaller unfunded pension liability compared to peers and the Land's conservative and forward-looking management of its pension fund.

### Guarantees of EUR 3bn, low risk of crystallisation

First, contractual guarantees stood at EUR 3.0bn in 2022 (23% of operating revenue), up from EUR 2.8bn in 2021. At YE 2022, only around EUR 1.7bn of these guarantees were utilised.

There is a limited risk that the obligations of entities and projects guaranteed by Saxony-Anhalt will crystallise onto the Land's balance sheet. Around EUR 1.9bn, or two thirds of total contractual guarantees, are related to the wholly-owned development bank Investitionsbank Sachsen-Anhalt. In line with other German development banks, we assess the risk stemming from the guarantee as very low, as the bank has ample capitalisation and liquidity, and runs a low-risk, development-oriented business model. Another 9% of guarantees are towards KfW (AAA/Stable), the federal development bank.

### Small number of shareholdings, self-sufficient entities

Second, contingency risks stemming from Saxony-Anhalt's shareholdings are low. The state had a total of 58 shareholdings with direct ownership shares at YE 2022, 20 of which are majority-owned. The most notable shareholdings are the wholly-owned Investitionsbank Sachsen-Anhalt, a 6%-stake in NordLB and two university hospitals (Magdeburg and Halle (Saale)).

The latest crystallisation of contingency risks of EUR 198m in 2019 was related to Saxony-Anhalt's share of costs due to the recapitalisation of NordLB, a Landesbank owned by a group of savings banks, the Land of Lower Saxony and Saxony-Anhalt. The recapitalisation included a comprehensive restructuring programme, strengthening the bank's balance sheet and profitability.

### Pension fund limits unfunded pension liabilities, full coverage for civil servants who entered after 2007

Finally, and in line with other Länder, Saxony-Anhalt has unfunded pension liabilities due to pensions related to its civil servants which need to be paid out of regular future budgets. However, we view the risk related to these liabilities as relatively lower than for most other states due to Saxony-Anhalt's conservative management via its pension fund, with assets worth EUR 1.9bn as of September 2023. The fund covers a relatively larger share of pension liabilities than for other states and receives EUR 300m in annual transfers to ensure a 100% coverage for civil servants that entered after 2007, and at least partial coverage for civil servants that entered before 2007. The pension fund will allow the Land to smooth pension payment peaks.

### Budgetary performance and flexibility

### Track record of solid budgetary performance

Saxony-Anhalt displayed solid budgetary performance between 2016 and 2019, with operating margins of an average 12% of operating revenue (see **Figure 4**, next page), in line with other Länder given an accommodative monetary and economic backdrop and consolidation efforts before the implementation of the debt brake at state level in 2020. Operating surpluses supported the Land's ability to cover interest payments and capital expenditure without the need for additional borrowing. As a result, the balance after capital accounts averaged 2% of total revenue between 2016-2019 (despite Saxony-Anhalt's EUR 198m contribution to the recapitalisation of NordLB in 2019).

### Covid-19 crisis led to deficits in 2020 and 2021

From 2020, the Covid-19 shock heavily impacted budgetary planning and fiscal outcomes. The Land's budget balance turned to a deficit (before debt movement) of 7.9% of total revenue in 2020 and 1.4% in 2021 (**Figure 4**). In 2020, a slight drop in tax revenue and operating expenditure growth of 11.4%, in particular driven by higher transfer expenditure, led to a deterioration in operating performance. In 2021, operating

performance recovered somewhat, but the Land implemented its Covid-19 special fund, funded via EUR 2bn in emergency credit authorisations.

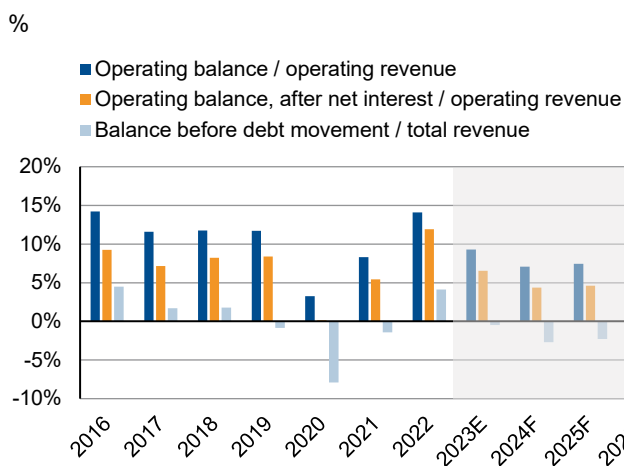
## Redemption of EUR 2.2bn emergency borrowing from 2029

Due to debt brake provisions, borrowings taken on under the emergency safeguard clause in 2020-2021 need to be redeemed according to a mandatory schedule. This amounts to EUR 2.2bn to be redeemed in EUR 100m annual tranches from 2029.

## A strong fiscal recovery in 2022

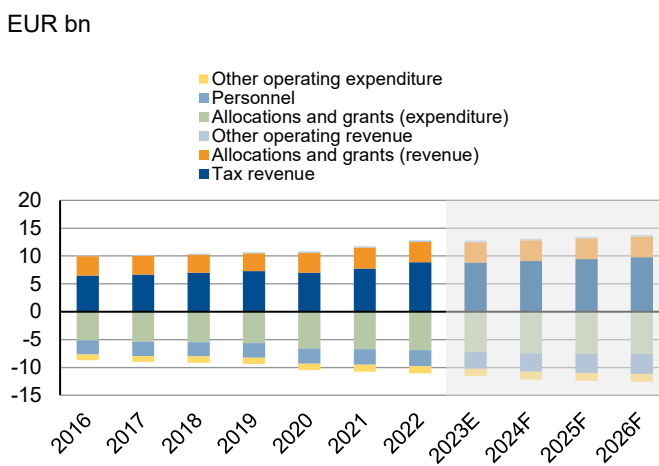
In 2022, the state posted strong results, ending the year with a EUR 560m surplus before debt movement, or 4.1% of total revenue. The better-than-expected result allowed the state to redeem EUR 25m in emergency borrowing and EUR 751m in net borrowing incurred under the cyclical component, and to allocate funds to its budgetary reserve. Financial performance benefitted from very strong nominal tax revenue, up 15% from 2021. This was primarily driven by robust growth in shared taxes. Operating expenditure grew by 2.5%.

**Figure 4: Budgetary performance**



Source: Land of Saxony-Anhalt, Destatis, Scope Ratings

**Figure 5: Components of operating balance**



Source: Land of Saxony-Anhalt, Destatis, Scope Ratings

## Small deficit expected for 2023...

For 2023, we expect a moderate deficit before debt movement of around 0.5% of total revenue. Tax revenues are expected to be broadly in line with budgeted levels at around EUR 8.8bn (-1% YoY), leading to broadly flat operating revenue growth relative to 2022. At the same time, we expect operating expenditure to grow by 5%, which would lead to a significant deterioration in the operating margin to 9.3% of operating revenue, from 14.1% in 2022. In addition, moderately higher interest expenses and elevated capital expenditure are expected to lead to the projected deficit. The Land has budgeted EUR 98m in net borrowing and EUR 315m of withdrawals from budgetary reserves. To fulfil the requirements of the constitutional court ruling, a supplementary budget added EUR 150m in net borrowing and a corresponding transfer to its Covid-19 special fund to cover its actual spending in 2023.

## ... and the remainder of the projection horizon.

For the years 2024 to 2026, we expect continued deficits after capital accounts of an average 1.8% of total revenue due to multiple budgetary headwinds. While budgetary performance will benefit from tax revenue growth of an average 3.4% per year, high operating and investment spending will more than offset increased tax revenue. Spending pressures arise from higher spending on personnel, not least due to the increase in salaries of employees agreed in December 2023 and corresponding pay rise for civil servants, higher operating transfers to municipalities and high planned capital expenditure, partly also due to the investment needs in coming years linked to Intel's planned chip manufacturing plant in the state.



### Budgetary pressures mitigated by track record in consolidation

In light of these budgetary pressures, financial planning will need to enforce tight expenditure control, also given that budgetary reserves will likely be exhausted in the near term. Overall, the state's commitment to fiscal consolidation, conservative budget management and low debt service costs will help mitigate budgetary risks and enable the state to follow its long-term fiscal consolidation strategy.

### Moderate expenditure flexibility, but above average

Saxony-Anhalt's flexibility to adjust expenditure is moderate, like for all Länder, due to its rigid structure, since minimum legislative requirements and the socially sensitive nature of several expenditure items make most items difficult to trim. At the same time, Saxony-Anhalt's above-average flexibility benefits from a high share of investment relative to total expenditure at an average 12.5% between 2018 and 2022, as well as a relatively lower share of personnel spending of around 27% of operating expenditure (including 4.2% of operating expenditure in pension spending (see **Figure 5**) which is much lower than the Länder average, a common feature among Eastern German states).

### Very limited revenue flexibility, stable and predictable revenue base

Saxony-Anhalt's revenue flexibility is very limited, as almost the entirety of operating revenue stems from shared taxes and intergovernmental transfers. In line with constitutional arrangements, the Länder receive shared taxes, largely revenues from personal income taxes, VAT and corporate taxes. These revenues are initially collected by regional tax offices but are later redistributed at a national level in accordance with revenue-sharing agreements and additional transfer mechanisms. While the revenue base of the state is inflexible, the stable and predictable nature of most of the revenue flows is a key credit strength for Saxony-Anhalt.

## Economy

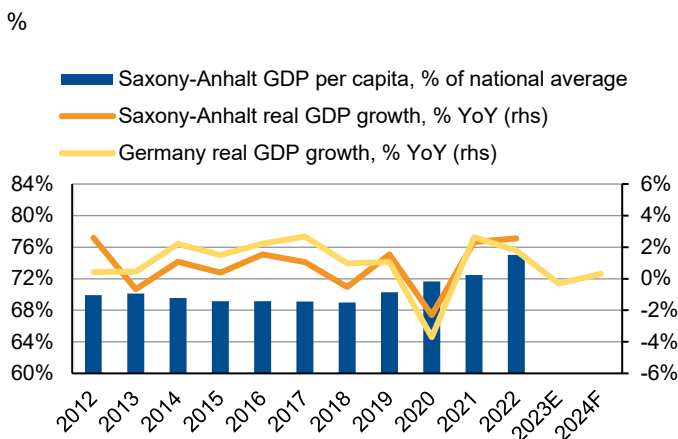
### Modest economic profile...

Saxony-Anhalt's economic profile is modest via-a-vis peers, with a relatively lower GDP per capita than the German average, a small economic size with a contribution to national GDP of around 2%, a higher unemployment rate and lower growth potential than peers, mostly driven by adverse demographic trends. In general, the federal equalisation system delinks to a large extent regional economic and tax revenue performance.

### ... but positive momentum in several areas.

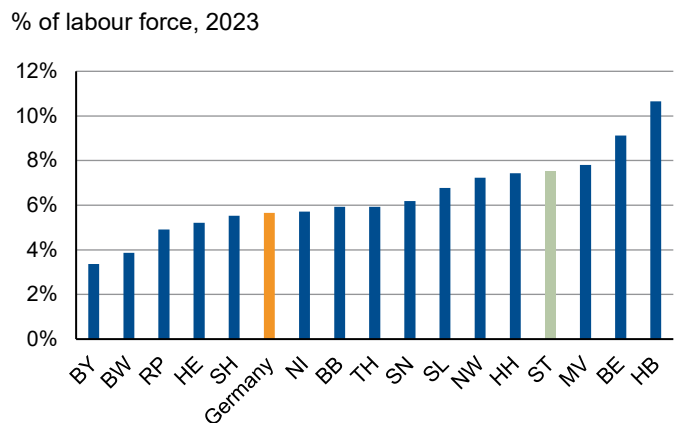
At the same time, we acknowledge positive trends, such as the planned construction of a large chip manufacturing plant by Intel, which will boost regional output and employment. Second, wealth levels are converging to the German average, with GDP per capita standing at EUR 34,505 in 2022, or 75.3% of the national average, up from 70% in 2012. This was particularly supported by real GDP growth rates overperforming in 2020-2022 on average (see **Figure 6**). Finally, net migration into Saxony-Anhalt from other Länder has been positive since 2014, reversing a former trend of negative net migration.

**Figure 6: Real GDP growth**



Source: Volkswirtschaftliche Gesamtrechnung der Länder, Scope Ratings

**Figure 7: Unemployment ratio**



Source: Destatis, Scope Ratings

### Economic structure relatively more exposed to energy shock

The Land's regional economic structure is relatively more skewed towards pharmaceuticals (around 20% of industrial gross value added), basic metals (9%) and agriculture (3.5% of total gross value added). This makes the economy less prone to cyclical swings, but also points towards a greater exposure to the current energy crisis, which particularly affects energy-intensive industry. This is reflected in the decline in real GDP in H1 2023 of 3.2% YoY, versus a 0.3% drop in Germany. We therefore expect real GDP growth in 2023 to underperform relative to the national economy. For Germany, we expect a drop in real GDP of 0.3%, and only a moderate recovery of 0.3% in 2024.

### Adverse demographics weigh on potential growth

In the medium term, we expect Saxony-Anhalt to grow at a slower pace than Germany, which is mostly driven by adverse demographics. The state's workforce has declined for years, with a drop in its working-age population (persons aged 15-66) of around 200,000 persons, or 12.6%, between 2010 and 2022. In the years to 2030, official population projections estimate the working-age population to shrink further by an annual 1.2% on average. This contributes negatively to potential growth, which we project at an average 0.2% for Saxony-Anhalt until 2030, against 0.7% for Germany as a whole.

### Labour markets are slowing but remain robust

In line with other Länder, the labour market has been robust, but the unemployment rate remains the fourth-highest among Länder, and the regional labour market slowed in 2023. The unemployment rate stood at 7.1% at YE 2022, back at its pre-pandemic level, before rising to 7.5% in December 2023 (see **Figure 7**).

### Quality of governance

#### Three-party coalition since 2021

The CDU, SPD and FDP formed a coalition with Dr. Rainer Haseloff (CDU) as minister president in 2021. We expect policy-continuity until the next scheduled elections in 2026.

#### Administration committed to fiscal consolidation

The state government's track record of formulating and implementing fiscal policy targeted at long-term fiscal sustainability and its commitment to the debt brake have been highlighted since the Covid-19 shock in 2020, with the state reacting with multiple supplementary budgets. At the same time, authorities will face the challenge of balancing future budgets via tightly controlling spending. For example, consolidation needs of around EUR 432m ('globale Minderausgaben') have been identified in the 2024 budget.

Finally, we deem Saxony-Anhalt's debt and liquidity management as comprehensive and effective, in line with the high governance standards of the German Länder.

### Environmental and social considerations

#### Climate strategy with concrete emissions reduction targets

In response to environmental risks, the state's adopted climate strategy spells out eight concrete and measurable targets for 2030 in support of the central government's climate strategy, with a target of climate net neutrality by 2045.

Saxony-Anhalt's primary target is to reduce regional annual greenhouse gas emissions by 5.65m tonnes of CO<sub>2</sub> equivalents between 2021 and 2026, and by 10m tonnes by 2030 (emissions were around 31m tonnes of CO<sub>2</sub> equivalents in 2021). The strategy also targets climate neutrality in line with the nationwide goal by 2045. Further, the share of renewable energy is to be increased, to 100% of gross electricity consumption by 2030, from 76% in 2021, and to 45% of primary energy consumption, from 26% in 2021.

#### Exposure to environmental risks, severely mitigated by federal solidarity principle

Saxony-Anhalt is exposed to both physical and transition environmental risks. A prominent risk relates to flooding, as highlighted by heavy rainfall and flooding catastrophes in 2002 and 2013. Also more recently, heavy rainfall led to flooding in some areas in Saxony-Anhalt since late December 2023. In response to past crises, the Land's flooding protection has been steadily improved, enhancing future resilience. After the 2013 flooding, the central and state governments set-up and co-financed a recovery fund of EUR 8bn, highlighting the federal solidarity principle.

**Federal grants support gradual transition away from coal**

Saxony-Anhalt is exposed to transition risks over coming years on its path to climate neutrality by 2045. As a lignite coal region, the region is gradually exiting coal production and closing down coal energy plants, with a full exit by 2038. A full exit from electricity production from coal would significantly reduce carbon emissions and support the state's emissions reduction path. The state's largest coal plant is scheduled to be closed down in 2034. The central government is supporting the region's coal exit via significant grants in support of the economic transition. These are particularly relevant also due to a high share of energy-intensive industries, such as pharmaceuticals, basic metals and cement.

Finally, to enhance the sustainability of its financial assets, for example assets held in its pension fund, Saxony-Anhalt employs an engagement approach via its ownership shares in listed companies.

**A shrinking and ageing population is the main social risk**

The main risk related to social factors is the state's shrinking and ageing population. Saxony-Anhalt has the highest share of persons aged 66 and older relative to the total population among German Länder, at around 26%, against the German average of 21%. Due to ageing, the state's population has been shrinking gradually for years, to around 2.19m people in 2022, from 2.24m in 2013.

The main budgetary risk linked to this trend is the state's allocation from the financial equalisation system, which is directly linked to population. Thus, the relatively quicker ageing of the state's society leads to annual losses relative to other states of EUR 60m. Further, a higher share of older people increases healthcare costs. Finally, the economy is facing a shortage of young and skilled labour, a trend that the state aims to address with its 'Fachkräftesicherungspakt', a main element of the state's economic policy to attract and retain skilled workers.

Finally, two main responsibilities linked to social factors are healthcare and education. In addition to its regular budgetary activities, the state is enhancing its future social resilience via its Covid-19 special fund of EUR 2bn, linked to its social bond framework of 63 measures to be implemented until 2027.

## I. Institutional Framework Assessment

To assess the institutional framework, we apply a Qualitative Scorecard (QS1) centred around 6 components. We assess each analytical component on a five-point scale ranging from a score of 0 for 'low' integration to 100 for 'full' integration. The institutional framework score, ranging from 0 to 100, is calculated as a simple average of these assessments. The score is then used to determine a rating range from the rating anchor level, within which the sub-sovereign's rating can be positioned.

Our assessment of intergovernmental integration between the Länder and the Federal Republic of Germany (AAA/Stable) results in an indicative **downward rating range of up to one notch** from the German sovereign, within which the Länder can be positioned according to their individual credit strengths.

### Institutional Framework scorecard (QS1)

Analytical components	Full integration (100)	Strong integration (75)	Medium integration (50)	Some integration (25)	Low integration (0)
Extraordinary support and bailout practices	●	○	○	○	○
Ordinary budgetary support and fiscal equalisation	●	○	○	○	○
Funding practices	○	○	●	○	○
Fiscal rules and oversight	●	○	○	○	○
Revenue and spending powers	●	○	○	○	○
Political coherence and multi-level governance	●	○	○	○	○

Integration score	92
<b>Downward rating range</b>	<b>0-1</b>

Institutional framework score	100 > x ≥ 90	90 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 > x ≥ 10	10 > x ≥ 0
Indicative rating range	0-1	0-2	0-3	0-4	0-5	0-6	0-7	0-8	0-9	0-10

## II. Individual Credit Profile

To assess the ICP, we apply a Qualitative Scorecard 2 (QS2), centred around 10 components underpinned by peer benchmarking. We assess each analytical component on a three-point scale by benchmarking a sub-sovereign's performance and risk exposures to that of peers. Scores are 0 for 'weaker', 50 for 'mid-range', and 100 for 'stronger' for each component. The individual credit profile score, ranging from 0 to 100, is calculated as a simple average of these assessments. In addition, we make two additional assessments for environmental factors and resilience and social factors and resilience, which can lead to adjustments of the ICP score by up to +/- 10 points.

We assess the individual credit profile of Saxony-Anhalt as **mid-range** vis-à-vis peers, with a **score of 45 out of 100**.

### Individual Credit Profile scorecard (QS2)

Risk pillar	Analytical components	Stronger (100)	Mid-range (50)	Weaker (0)
Debt and liquidity 40%	Debt burden & trajectory	○	○	●
	Debt profile & affordability	○	●	○
	Contingent liabilities	●	○	○
	Liquidity position & funding flexibility	○	●	○
Budget 30%	Budgetary performance & outlook	○	●	○
	Revenue flexibility	○	○	●
	Expenditure flexibility	●	○	○
Economy 20%	Wealth levels & economic resilience	○	○	●
	Economic sustainability	○	○	●
Governance 10%	Governance & financial management quality	●	○	○
Additional environmental and social factors		Positive impact (+5)	No impact (0)	Negative impact (-5)
Environmental factors and resilience		○	●	○
Social factors and resilience		○	●	○

ICP score	45
Indicative notching	0

## III. Mapping Table

We derive the indicative sub-sovereign rating by mapping the result of the institutional framework assessment (i.e. the indicative rating range) to the ICP score.

For Saxony-Anhalt, this results in an indicative rating aligned with the sovereign rating of AAA. No additional considerations apply.

Rating anchor	Institutional framework assessment		Individual credit profile score							
	Score	Downward rating range	100 > x ≥ 80	80 > x ≥ 70	70 > x ≥ 60	60 > x ≥ 50	50 > x ≥ 40	40 > x ≥ 30	30 > x ≥ 20	20 > x ≥ 0
Federal Republic of Germany  AAA/Stable	100 > x ≥ 90	0-1	AAA	AAA	AAA	AAA	AAA	AAA	AA+	AA+
	90 > x ≥ 80	0-2	AAA	AAA	AA+	AA+	AA+	AA+	AA	AA
	80 > x ≥ 70	0-3	AAA	AA+	AA+	AA+	AA	AA	AA-	AA-
	70 > x ≥ 60	0-4	AAA	AA+	AA+	AA	AA	AA-	AA-	A+
	60 > x ≥ 50	0-5	AAA	AA+	AA+	AA	AA	AA-	A+	A
	50 > x ≥ 40	0-6	AAA	AA+	AA+/AA	AA/AA-	AA/AA-	AA-/A+	A+/A	A-
	40 > x ≥ 30	0-7	AAA	AA+/AA	AA+/AA	AA/AA-	AA-/A+	A+/A	A-/A-	BBB+
	30 > x ≥ 20	0-8	AAA	AA+/AA	AA/AA-	AA-/A+	A+/A	A-/A-	A-/BBB+	BBB
	20 > x ≥ 10	0-9	AAA	AA+/AA	AA/AA-	AA-/A+	A+/A	A-/A-	BBB+/BBB	BBB-
10 > x ≥ 0	0-10	AAA	AA+/AA	AA/AA-	AA-/A+	A-/A-	BBB+/BBB	BBB-/BB+	BB+	

Note: Mapping table under section 4 of Scope's [Sub-sovereigns Rating Methodology](#), as applied to the rating anchor's AAA-ratings.

**IV. Statistical Overview**

	2016	2017	2018	2019	2020	2021	2022	2023E	2024F	2025F	2026F
<b>Budgetary Performance (EUR m)</b>											
Operating revenue	10,131	10,199	10,413	10,646	10,825	11,729	12,829	12,771	13,109	13,436	13,792
<i>Operating revenue growth, %</i>		0.7%	2.1%	2.2%	1.7%	8.3%	9.4%	-0.5%	2.7%	2.5%	2.6%
Tax revenue	6,497	6,638	7,007	7,281	7,014	7,730	8,885	8,803	9,122	9,429	9,765
Allocations and grants	3,446	3,355	3,223	3,173	3,600	3,776	3,660	3,678	3,697	3,715	3,734
Other operating revenue	188	206	184	192	211	223	283	289	291	292	293
Operating expenditure	8,692	9,019	9,190	9,399	10,475	10,753	11,021	11,583	12,182	12,435	12,608
<i>Operating expenditure growth, %</i>		3.8%	1.9%	2.3%	11.4%	2.7%	2.5%	5.1%	5.2%	2.1%	1.4%
Personnel	2,541	2,549	2,573	2,636	2,741	2,773	2,873	3,050	3,340	3,491	3,561
Allocations and grants	5,122	5,426	5,487	5,647	6,589	6,734	6,906	7,217	7,433	7,508	7,583
Other operating expenditure	1,029	1,043	1,131	1,116	1,144	1,246	1,241	1,316	1,408	1,436	1,465
Operating balance	1,439	1,180	1,223	1,247	351	976	1,808	1,187	928	1,002	1,184
Interest received	7	4	-1	5	-9	-7	-8	2	6	0	0
Interest paid	510	455	366	359	327	333	274	355	360	380	400
Net interest paid	503	451	367	354	336	340	282	353	354	380	400
Current balance	936	730	856	893	15	636	1,526	834	574	622	784
Capital balance	-451	-546	-659	-989	-920	-812	-966	-900	-950	-950	-850
Balance before debt movement	486	184	197	-95	-905	-176	560	-66	-376	-328	-66
New borrowing (credit market)	4,875	4,211	3,399	5,250	4,726	6,493	908	3,421	3,428		
Debt redemption (credit market)	4,975	4,311	3,499	5,152	4,209	4,397	2,032	3,323	3,242		
Net borrowing	-100	-100	-100	98	517	2,097	-1,124	98	186		
<b>Debt (EUR m)</b>											
Direct debt	20,330	20,791	19,932	20,894	21,221	21,901	22,924	23,022	23,208	23,536	23,602
Guarantees	1,933	1,921	1,885	1,834	2,571	2,770	2,997	2,997	2,997	2,997	2,997
Overall debt risk (direct debt plus guarantees)	22,263	22,712	21,817	22,728	23,792	24,671	25,921	26,019	26,205	26,533	26,599
<b>Financial ratios</b>											
Debt/operating revenue, %	200.7%	203.9%	191.4%	196.3%	196.0%	186.7%	178.7%	180.3%	177.0%	175.2%	171.1%
Debt/operating balance, years	14.1	17.6	16.3	16.8	60.5	22.4	12.7	19.4	25.0	23.5	19.9
Interest payments/operating revenue, %	5.0%	4.5%	3.5%	3.4%	3.0%	2.8%	2.1%	2.8%	2.7%	2.8%	2.9%
Implicit interest rate, %	2.5%	2.2%	1.8%	1.7%	1.5%	1.5%	1.2%	1.5%	1.6%	1.6%	1.7%
Operating balance/operating revenue, %	14.2%	11.6%	11.7%	11.7%	3.2%	8.3%	14.1%	9.3%	7.1%	7.5%	8.6%
Balance before debt movement/total revenue, %	4.5%	1.7%	1.8%	-0.8%	-7.9%	-1.4%	4.1%	-0.5%	-2.7%	-2.3%	-0.4%
Transfers and grants/operating revenue, %	34.0%	32.9%	31.0%	29.8%	33.3%	32.2%	28.5%	28.8%	28.2%	27.7%	27.1%
Capital expenditure/total expenditure, %	10.9%	11.5%	11.8%	14.5%	12.6%	10.6%	13.1%	13.1%	13.2%	12.9%	11.9%
<b>Economy and demographics</b>											
Nominal GDP, EUR m	58,991	60,909	62,039	64,692	64,198	68,253	75,436				
GDP per capita, EUR	26,325	27,317	28,000	29,385	29,345	31,381	34,505				
GDP per capita, % of national GDP per capita	69.2%	69.1%	69.0%	70.3%	71.7%	72.5%	75.0%				
Real GDP growth, %	1.5%	1.0%	-0.5%	1.6%	-2.3%	2.3%	2.6%				
Population, '000s	2,236	2,223	2,208	2,195	2,181	2,169	2,187				
Unemployment rate, % labour force	9.6%	8.4%	7.7%	7.1%	7.7%	7.3%	7.1%				

Source: Land of Saxony-Anhalt, Destatis, Statistische Ämter des Bundes und der Länder, Scope Ratings





## Scope Ratings GmbH

### Headquarters Berlin

Lennéstraße 5  
D-10785 Berlin

Phone +49 30 27891 0

### Oslo

Karenslyst allé 53  
N-0279 Oslo

Phone +47 21 09 38 35

### Frankfurt am Main

Neue Mainzer Straße 66-68  
D-60311 Frankfurt am Main

Phone +49 69 66 77 389 0

### Madrid

Paseo de la Castellana 141  
E-28046 Madrid

Phone +34 91 572 67 11

### Paris

10 avenue de Messine  
FR-75008 Paris

Phone +33 6 6289 3512

### Milan

Via Nino Bixio, 31  
20129 Milano MI

Phone +39 02 30315 814

## Scope Ratings UK Limited

### London

52 Grosvenor Gardens  
London SW1W 0AU

Phone +44 20 7824 5180

[info@scoperatings.com](mailto:info@scoperatings.com)  
[www.scoperatings.com](http://www.scoperatings.com)

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