

CREDIT OPINION

12 December 2022

Update



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RATINGS

Saxony-Anhalt, Land of

Domicile	Germany
Long Term Rating	Aa1
Type	LT Issuer Rating - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Land of Saxony-Anhalt (Germany)

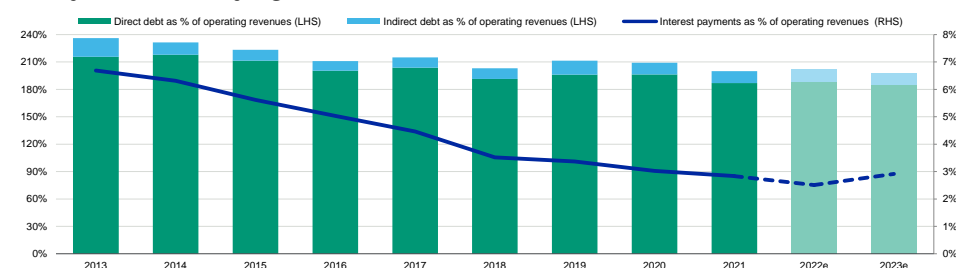
Update to credit analysis

Summary

The credit profile of the [Land of Saxony-Anhalt](#) (Aa1 stable) reflects the very supportive federal equalisation system, but also its overall strong governance and management practices and its excellent capital market access. The rating also takes into account the very high debt level, which is likely to remain at net direct and indirect debt (NDID) of about 200% of operating revenue in 2022 (see Exhibit 1). In 2022, we expect that the Land can achieve a solid financial surplus, despite headwinds from current economic slowdown in combination with high inflation rates. Still, the Land has low fiscal flexibility. The credit profile also reflects the very high likelihood that the [Government of Germany](#) (Aaa stable) would provide support if the Land were to face acute liquidity stress.

Exhibit 1

Saxony-Anhalt has very high debt, but still low interest cost



2022-23e - Moody's estimate.

Sources: Issuer, German Statistics Office and Moody's Investors Service

Credit strengths

- » Strong financial equalisation system, which ensures federal transfers and revenue predictability
- » Sound debt management and good capital market access

Credit challenges

- » Budgetary pressure weighs on financial performance
- » Very high debt burden
- » Modest tax base, with limited financial flexibility to raise additional revenue

Rating outlook

The stable rating outlook reflects our expectation that Saxony-Anhalt will be able to return to balanced budgets and declining debt burdens following the temporary effect of the pandemic. In case of a deeper and longer economic shock than currently expected, strong institutions and governance at the Länder (regions) and national levels are likely to foster resilience and contribute to a prompt resumption of strong financial positions.

Factors that could lead to an upgrade

A substantial reduction in the Land's debt burden, combined with an improvement in its financial performance, could lead to a rating upgrade.

Factors that could lead to a downgrade

Downward pressure on the ratings could occur if fiscal performance and debt burdens deviated materially and durably from our current projections. This could occur should economic growth deteriorate sharply and the Land was unable to contain the medium-term implications on its fiscal balances and debt burdens. In addition, a downgrade of the sovereign rating, or any indication of weakening government support, would likely lead to a downgrade.

Key indicators

Exhibit 2

Land of Saxony-Anhalt

	2018	2019	2020	2021	2022e	2023e
Population (in mn)	2.2	2.2	2.2	2.2	2.2	2.2
GDP per capita (in EUR)	27,997	29,123	28,652	29,798	32,000	34,000
GDP per capita as % of national average	69.2	70.2	71.5	70.9	71.0	71.1
Intergovernmental revenues as % of operating revenues	31.0	29.8	33.2	32.2	25.1	24.5
Interest payments as % of operating revenues	3.5	3.4	3.0	2.8	2.5	2.9
Gross operating balance (GOB) as % of operating revenues	8.2	8.4	0.1	-14.1	10.5	8.9
Capital expenses (Capex) as % of total expenses	11.8	14.5	12.6	10.4	16.4	13.3
Financing result (surplus or deficit) as % of total revenues	1.8	-0.8	-7.9	-19.7	1.7	0.6
Net direct and indirect debt (NDID) as % of operating revenues	203.1	211.4	209.2	199.9	202.3	197.8
Short-term direct debt as % of total direct debt	21.4	13.9	13.7	7.5	8.0	9.3

2022-23e - Moody's forecast.

Source: Issuer, German Statistics Office and Moody's Investors Service

Detailed credit considerations

On 19 August 2022, we affirmed Saxony-Anhalt's Aa1 senior unsecured debt ratings and (P)Aa1 senior unsecured MTN program rating and stable outlook. We also affirmed the Other Short Term (P)P-1 rating and its Commercial Paper P-1 rating.

The credit profile of Saxony-Anhalt, as expressed in its Aa1 stable rating, combines a Baseline Credit Assessment (BCA) of aa3 and a very high likelihood of extraordinary support from the federal government in the event that the Land faces acute liquidity stress.

Baseline Credit Assessment

Strong financial equalisation system, which ensures federal transfers and revenue predictability

The institutional framework, which encompasses the legislative background and financial flexibility, is reflected in the arrangements determining intergovernmental relations at all levels, and jurisdictional powers and responsibilities. The framework is mature and highly developed, with minor changes occurring at a measured pace and in a transparent manner.

Germany has one of the strongest equalisation systems worldwide. The German federal constitution guarantees that Länder receive appropriate levels of funding and prescribes high fiscal homogeneity among them. With the amended financial equalisation scheme

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from 2020, the Länder sector (at the expense of the federal government) benefitted financially because of a higher share in value-added tax revenue, higher general federal transfers and higher supplementary transfers. Under the financial equalisation system, Saxony-Anhalt benefits from special financial subsidies because of its status as a financially relatively weaker region. Intergovernmental revenue makes up nearly one-third of the Land's revenue.

Another institutional factor to align Länder budgets and discipline is a constitutional requirement (debt-brake mechanism) that mandates each region to maintain structurally balanced budgets from 2020. However, the constitutional requirement has been suspended for 2020, 2021 and 2022 because of the extraordinary emergency situation, which allows for debt-funding of measures to alleviate the economic and social impact of the pandemic. Saxony-Anhalt committed to repay any pandemic-induced debt from 2022 over the coming three years.

Sound debt management and good capital market access

Saxony-Anhalt's reporting is transparent, timely and accurate, while budgetary management is characterised by a high degree of prudence. Like other German Länder, the Land shows strong institutional capacity.

Active debt management and sound liquidity ease the burden of Saxony-Anhalt's debt-service requirements. Foreign-currency risks are fully hedged, while the Land's outstanding debt has an average maturity of around nine years. More than 90% of debt has a fixed interest rate, with limited interest rate risk, but there is some exposure to derivatives. The Land actively uses forward interest hedges and thereby has locked in very low interest rates for a significant portion of its maturities.

The share of short-term debt has been declining over the recent years, from about 20% of direct debt five years ago to less than 10% of direct debt in 2021 and following years. We observe lower volume of maturing debt, thanks to its tendency towards longer maturities when refinancing maturing debt in recent years. We also note a lower utilisation of Saxony-Anhalt's commercial paper (CP) programme, which is a unique feature among German Länder. The Land uses its CP programme to maintain access to various investor groups and invests its excess liquidity at highly rated counterparties, maturing within a year.

The Land has financial relationships with a broad range of investors, which are willing to grant continued access to liquidity based on their confidence in the German Länder solidarity system. Its bonds are eligible for the European Central Bank's current purchasing programmes, which supports capital market access.

In the money markets, the Land has access to the inter-Länder liquidity pool, whereby individual Länder offer their surplus cash to other Länder, as well as access to the German state financing agency (BRD Finanzagentur GmbH).

Interest expenses are expected to account for a modest 2.5% of operating revenue in 2022, having decreased steadily and significantly from levels of up to 9% in the past decade. Saxony-Anhalt's overall amortisation profile is relatively balanced, and its access to capital markets is very good, based on a broad set of instruments and a sophisticated state treasury management.

Budgetary pressure weighs on financial performance

With current headwinds from geopolitical and economic risk from the Russia-Ukraine military conflict resulting in slower than expected economic growth, in combination with high inflation rates, we expect uncertainty around the predictability and planning of budget and execution to persist. The current energy crisis as well as high inflationary environment will affect the land's budget by nominally boosting tax revenues, but also increasing cost. Should the current headwinds from geopolitical and economic risk result in slower than our currently expected baseline scenario, the Land's fiscal health is at risk.

The coronavirus pandemic and the resulting economic and financial effects hit Saxony-Anhalt, requiring debt funding to cover tax revenue shortfalls and higher spending in 2020 and 2021, although the impact was less severe than we had initially expected.

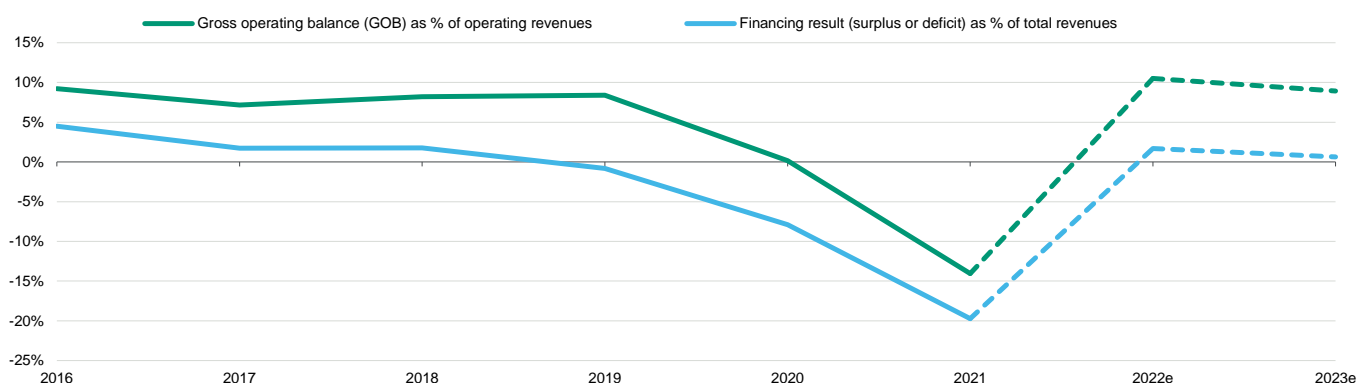
In 2022, we expect a strong gross operating surplus of around 10% of operating revenue, while in 2021, the state's operating balance was impacted by a one-off budgeting for setting up a special fund (Sondervermögen) to partly pre-finance some future expenses, which had led to an extraordinary high operating deficit of 14% of operating revenue reported in 2021. In following years we expect the operating balance to stabilise at 9% to 10% of operating revenue.

Despite slower than expected economic growth, nominal tax revenue is expected to continue to grow over the coming five years at 3% to 6% each year, while in 2021, because of the economic recovery and catch-up effects, tax revenue recovered a surprisingly high growth of more than 10% compared with 2020, when tax revenue fell as a result of the pandemic and the related slowdown in economic activity. Over the course of the pandemic, central government transfers, which were higher than initially expected, have helped the state to limit financial burden.

In 2022 we expect the Land to achieve a financial surplus, while in 2021, due to above mentioned one-off effect, Saxony-Anhalt reported a high financing deficit of 20% of total revenue. Our baseline assumption for 2023 projects a balanced financial result.

Exhibit 3

The pandemic has put some pressure on operating and financial performance



2022-23e - Moody's estimate.

Sources: Issuer, German Statistics Office and Moody's Investors Service

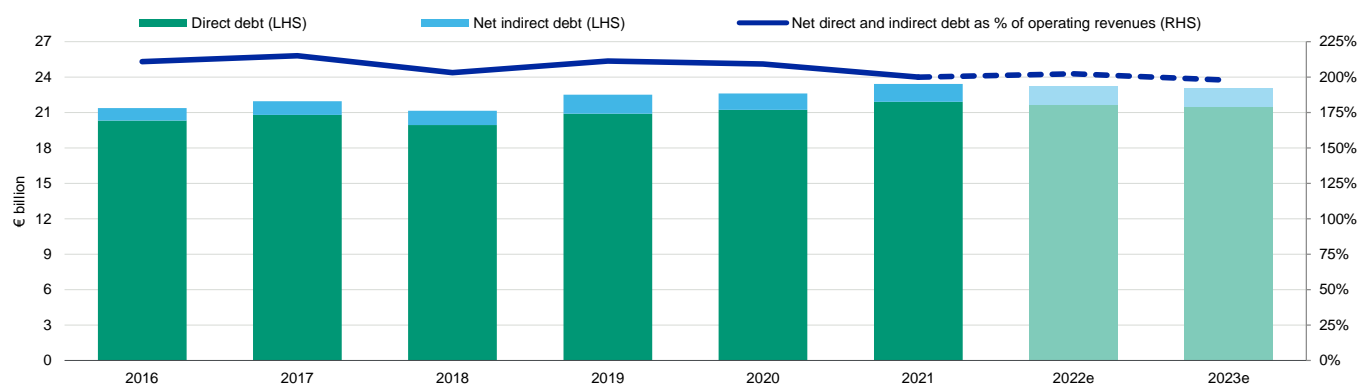
Very high debt burden

The Land's direct debt is expected to remain relatively stable at 189% of operating revenue at year-end 2022, compared to 187% a year earlier. We expect direct debt to remain at similar level in 2023 and 2024, before declining slowly thereafter. The ratio is very high in an international context and is above the German Länder average of 124% as of 2021.

If we include indirect debt (for example, some guarantees), Saxony-Anhalt's net direct and indirect debt (NDID) ratio is expected to stand at slightly above 200% of operating revenue as of year-end 2022, and we expect it will remain at similar level in 2023 and 2024, before declining slowly thereafter. The Land's indirect debt mainly consists of guarantees for subsidiary company debt, housing projects, and small and medium-sized businesses.

Exhibit 4

Saxony-Anhalt's debt burden remains very high



2021-22e - Moody's estimate.

Sources: Issuer, German Statistics Office and Moody's Investors Service

Saxony-Anhalt's contingent liabilities are very limited compared with those of most German Länder. The Land holds a relatively low number of participations in companies and other entities, which overall are self-supporting. Saxony-Anhalt holds and provides guarantees to a regional development bank (Investitionsbank Sachsen-Anhalt), which provides services to local small and medium-sized enterprises, supports real estate development and lends to the local government sector. Investitionsbank Sachsen-Anhalt is legally a part of [Norddeutsche Landesbank GZ](#) (Nord/LB, A3 stable), in which the Land holds a small minority stake of 7%. In 2021, the Land decided to take steps to set up Investitionsbank Sachsen-Anhalt as an individual institution (that is legally separate from Nord/LB)¹.

Similar to those of all German Länder, Saxony-Anhalt's pension obligations are only partially funded. The Land established a pension fund and aims to cover obligations of all newly employed civil servants from 2007. Saxony-Anhalt's unfunded obligations are significantly lower than those of many West German Länder. In general, pension obligations could limit budget flexibility and affect a region's creditworthiness. However, we regard the setup of a pension fund as a forward-looking first step towards addressing the budget impact of unfunded liabilities.

Modest tax base, with limited financial flexibility for raising additional revenue

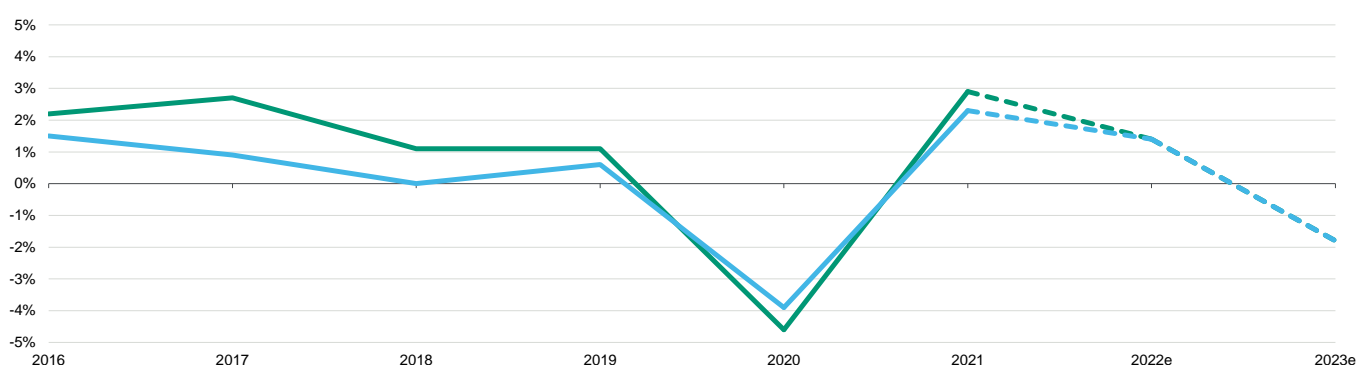
In general, Saxony-Anhalt, like other German Länder, has little flexibility to adjust revenue or expenditure in its budget. Significant budgetary pressure persists for Saxony-Anhalt, although its budgetary discipline is good.

Saxony-Anhalt's economy is still in transition, but the Land's restructuring efforts are taking effect, as recently demonstrated by an announcement of chip manufacturer [Intel Corporation](#) (A1) to build a factory close to Saxony-Anhalt's capital city Magdeburg. Typically, growth remains weaker than that for the western Länder. Overall, GDP growth is often slightly below the national rate (see Exhibit 4), like in 2021, when the German economic growth was 2.9% while Saxony-Anhalt's growth was 2.1%. The Land's total GDP accounts for only 2% of Germany's national GDP, and Saxony-Anhalt's per capita GDP is around 70% of the German average.

In 2022, we expect the economic recovery to continue at a significantly lower pace due to the heightened uncertainty brought about by the Russia-Ukraine military conflict. We [revised our real GDP growth forecasts](#) for Germany downwards to 1.4% in 2022 (from 3.8% respectively before the invasion) and -1.8% in 2023 to reflect the German industrial sector's exposure to higher energy prices, broader supply chain disruption and a drop in household consumption.

Exhibit 5

Saxony-Anhalt's economy has been somewhat less burdened by the pandemic unlike Germany as a whole



2022-23e - Moody's forecast.

Sources: Issuer, German Statistics Office and Moody's Investors Service

Saxony-Anhalt has had a longer period of adverse demographics with migration and age structure weaker than for German average. The pace of outward migration has slowed, although it remains potentially negative for the economy and for the budget because both the original tax base and transfer payments are based on population figures. An ageing population will lead to economic (declining labor supply reducing revenues) and expenditure (higher pension and other social costs) pressures, which is one of Saxony-Anhalt's social risks.

Extraordinary support considerations

The very high likelihood of extraordinary support from the Federal Government of Germany reflects our assessment of the high reputational risk for Germany as a whole in case of default by a Land, and the Bundestreuekonzept, according to which all German Länder must express mutual solidarity in the event that one of them or the Federal Republic faces a severe budgetary crisis. Also, the debt volumes and structure of German Länder are extremely complex and an event of nonpayment would be considered to have a corresponding impact on Germany as a whole. In our opinion, the principle of solidarity is firmly entrenched in the Grundgesetz (basic law), thereby providing a reassurance that, if required, financial support for a member in distress would be forthcoming. We have, therefore, incorporated two notches of uplift, to Aa1 from aa3, into Saxony-Anhalt's final rating.

ESG considerations

Land of Saxony-Anhalt's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 6

ESG Credit Impact Score

CIS-2

Neutral-to-Low

For an issuer scored CIS-2 (Neutral-to-Low), its ESG attributes are overall considered as having a neutral-to-low impact on the current rating; i.e., the overall influence of these attributes on the rating is non-material.

NEGATIVE IMPACT : POSITIVE IMPACT

Source: Moody's Investors Service

The Land of Saxony-Anhalt's ESG Credit Impact Score is neutral-to-low (**CIS-2**), reflecting neutral-to-low exposure to environmental and moderately negative social risk, along with very strong governance and policy effectiveness that mitigates the region's susceptibility to these risks.

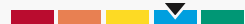
Exhibit 7

ESG Issuer Profile Scores

ENVIRONMENTAL

E-2

Neutral-to-Low



SOCIAL

S-3

Moderately Negative



GOVERNANCE

G-1

Positive



Source: Moody's Investors Service

Environmental

The environmental issuer profile score is neutral-to-low (**E-2**), reflecting neutral-to-low risks for all environmental factors. Despite its traditional high exposure to heavy industries the Land has carbon emission levels somewhat above per capita German average, with Saxony-Anhalt promoting carbon transition schemes.

Social

The moderately negative social issuer profile score (**S-3**) reflects risks foremost on demographics (which scores highly negative) as well as labour and income (which scores moderately negative), somewhat counterbalanced by broadly neutral-to-low risks from most other social factors, except for health and safety (which scores positive). The main risk is driven by the region's relatively adverse

demographics with migration and age structure weaker than for Germany overall. The trend of ageing population will result in declining labour supply and higher pension and social cost.

Governance

The positive governance issuer profile score (**G-1**) reflects the very strong national institutional and governance framework. Budgetary discipline in Germany is a constitutional requirement, which requires each of the regions to maintain structurally balanced budgets. Budget planning in Saxony-Anhalt is prudent, transparent and highly predictable.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

All of these considerations are further discussed in the "Detailed credit considerations" section above. Our approach to ESG is explained in our report on how the [scores depict limited impact of ESG factors in advanced economy RLGs, negative in emerging markets](#) and our cross-sector methodology [General Principles for Assessing Environmental, Social and Governance Risks Methodology](#).

Rating methodology and scorecard factors

The assigned BCA of aa3 is close to the scorecard-indicated BCA. The matrix-generated BCA of aa3 reflects an Idiosyncratic Risk score of 3 (presented below) on a 1-9 scale, where 1 represents the strongest relative credit quality and 9 the weakest; and a Systemic Risk score of Aaa, as reflected in the sovereign bond rating of Germany.

For details about our rating approach, please refer to [Rating Methodology: Regional and Local Governments](#), published on 16 January 2018.

Exhibit 8

Saxony-Anhalt, Land of Regional & Local Governments

Baseline Credit Assessment – Scorecard	Score	Value	Sub-factor Weighting	Sub-factor Total	Factor Weighting	Total
Factor 1: Economic Fundamentals				6.60	20%	1.32
Economic Strength [1]	9	70.98%	70%			
Economic Volatility	1		30%			
Factor 2: Institutional Framework				3	20%	0.60
Legislative Background	1		50%			
Financial Flexibility	5		50%			
Factor 3: Financial Position				3.75	30%	1.13
Operating Margin [2]	9	-6.79%	12.5%			
Interest Burden [3]	3	2.96%	12.5%			
Liquidity	1		25%			
Debt Burden [4]	7	199.94%	25%			
Debt Structure [5]	1	7.51%	25%			
Factor 4: Governance and Management				1	30%	0.30
Risk Controls and Financial Management	1					
Investment and Debt Management	1					
Transparency and Disclosure	1					
Idiosyncratic Risk Assessment						3.35 (3)
Systemic Risk Assessment						Aaa
Scorecard-Indicated BCA Outcome						aa2
Assigned BCA						aa3

[1] Local GDP per capita as % of national GDP per capita

[2] Gross operating balance/operating revenues

[3] Interest payments/operating revenues

[4] Net direct and indirect debt/operating revenues

[5] Short-term direct debt/total direct debt

Source: Moody's Investors Service; Fiscal 2021.

Ratings

Exhibit 9

Category	Moody's Rating
SAXONY-ANHALT, LAND OF	
Outlook	Stable
Baseline Credit Assessment	aa3
Issuer Rating	Aa1
Senior Unsecured	Aa1
Commercial Paper -Dom Curr	P-1
Other Short Term -Dom Curr	(P)P-1

Source: Moody's Investors Service

Endnotes

¹ We do not count guarantees provided for Investitionsbank Sachsen-Anhalt as indirect debt as we view them as contingent liabilities.

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