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Research Update:

State of North Rhine-Westphalia 'AA/A-1+' Ratings Affirmed, Outlook Remains Negative

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Overview

- Germany's currently subdued economic growth weighs on tax collection, and hence on the budgetary performance of the State of North Rhine-Westphalia (NRW) in 2025.
- Our expectation of a gradual recovery in NRW's fiscal position from 2026 hinges critically on the new national spending packages having the anticipated materially positive effect on GDP growth and on continuing expenditure discipline by the state.
- Consolidation efforts notwithstanding, we believe NRW will utilize the deficit allowance for state governments that was just inserted into Germany's constitution and therefore post limited negative results after capital accounts.
- We affirmed our 'AA/A-1+' long- and short-term ratings on NRW and maintained the negative outlook.

Rating Action

On April 25, 2025, S&P Global Ratings affirmed its 'AA/A-1+' long- and short-term issuer credit ratings on the German State of North Rhine-Westphalia (NRW). The outlook remains negative. The 'AA' issue ratings on NRW's senior unsecured debt were also affirmed.

Outlook

The negative outlook reflects the risk that future tax revenue growth and the fiscal discipline of NRW's management may prove insufficient to ensure that NRW will meet the assumptions in our base case. For now, however, we still anticipate an eventual recovery in operating margins and a return to deficits after capital accounts well inside the now wider limit implied by Germany's revised constitutional rules. We also expect a continuation of the gradual decline of NRW's relative debt burden if the upcoming assumption of municipal legacy debt is disregarded.

Downside scenario

We could lower the rating on NRW over the next 18 months if the state fails to reestablish operating margins structurally above 5%, and this results at least partially from insufficient consolidation efforts by the administration. In particular, we could reassess our view on the state's financial management if, to ensure compliance with the newly widened fiscal rules, NRW still resorted to reserve mobilization, another debt brake suspension, or other one-off unorthodox measures, instead of aiming for recurring budgetary improvements.

Upside scenario

We could revise the outlook to stable over the next 18 months if budgetary performance improves in line with our current expectations and if NRW's relative debt burden and its contingent liabilities continue to decline, notwithstanding the upcoming municipal legacy debt assumption.

Rationale

Our ratings on NRW reflect the expectation that Germany's recent decisions on massively higher infrastructure and defense spending will eventually have a positive effect on economic growth, thereby boosting state tax revenue. NRW should then have budgetary resources to restore better operating margins despite rising costs if it upholds strong fiscal discipline. Promised federal funding from the planned German infrastructure package will likely help finance planned transformative capital expenditure. The now looser debt brake should remove the need for NRW to offset budgetary shortfalls with the one-off and accounting-only transactions it employed in the recent past. However, the relaxation of rules points to limited deficits after capital accounts as the new budgetary equilibrium for the state.

NRW benefits from its large and diversified economy, sophisticated debt management, and an exceptionally strong liquidity position. A very high debt burden, including remaining contingent liability risks, constitutes the weakest aspect of the rating.

The negative outlook speaks to the not immaterial risk that economic--and hence tax revenue growth--may disappoint, or that fiscal discipline could prove insufficient.

Currently weak economic growth, planned federal stimulus spending, and a loosening of Germany's debt brake set the scene for NRW's fiscal development

The reaction of German economic growth to the country's newly planned massive stimulus package is a key parameter for the determination of NRW's fiscal trajectory in the near future. In an extraordinary session, Germany's federal parliament recently voted into place a €500 billion special infrastructure spending envelope and carved out unlimited defense spending from the expenditure ceiling otherwise set by the country's debt brake. S&P Global Ratings believes that, when executed, this should eventually translate into higher economic growth. Accordingly, we now forecast German real GDP growth to rise to 1.4 in 2026, 1.7% in 2027, and 1.6% in 2028, from merely 0.3% in 2025. Shared taxes--primarily on payroll, personal income, and corporate income, and value-added tax (VAT)--are closely linked to contemporaneous economic growth. Given these taxes make up about 80% of NRW's and its peers' total adjusted revenue, the state's finances should immediately benefit from the anticipated developments. Conversely, if such an economic recovery failed to materialize, this would materially exacerbate budgetary pressures for NRW.

In our view, the recent replacement of the balanced budget requirement for German states with a structural deficit allowance has significantly increased fiscal latitude and should make it easier for NRW to produce compliant and transparent budgets. The country's debt brake was loosened with an amendment to Germany's constitution in late March of this year, after the national snap election. It arguably constitutes the biggest change in many years to the institutional framework that the federal states operate under. We calculate that, for NRW, the new deficit ceiling of--in the absence of special circumstances--0.35% of GDP currently translates into a permitted structural deficit of about €3 billion per year, or almost 3% of the state's operating revenue. We believe that this change removes some of the pressure on NRW to repeat the one-off and accounting-only transactions that were employed in the recent past to offset budgetary shortfalls and produce compliant budgets. In this sense, the constitutional alignment can be seen to support transparency. That said, it obviously also reduces the minimum requirement for acceptable budgetary performance in ordinary times, and we believe that it shifts political power from the finance minister to the other department heads during budget negotiations.

We have currently no visibility on the detailed implementation of the second key change to the fiscal environment for Germany's states, namely the set-up of the €500 billion infrastructure fund, from which Germany's states are to receive €100 billion over 12 years. Lacking better information, we therefore assume that NRW will receive an annual transfer of €1.7 billion from mid-2025. This prorates an amount proportional to NRW's relative population and share in national GDP over the fund's stated life. We anticipate a legal requirement to increase capital expenditure by an equivalent amount in our financial modelling.

Despite the additional transfers and the increased latitude for deficits, we see continuing pressure on NRW's financial management to implement further consolidation measures. Cost inflation, particularly with regard to salaries and social transfers, has been rampant in the recent past. A simple extrapolation of these trends could, in our view, easily produce shortfalls beyond what is permissible under the looser rules. The upcoming collective bargaining negotiations for state employees toward the end of this year mark a key event in this respect. However, we understand that the state's financial leadership wants to retain strong fiscal discipline and control expenditure growth, even as it has now been granted slightly more budgetary breathing space.

Current weak fiscal dynamics notwithstanding, NRW continues to benefit from its strong and diversified economic base. The state accounts for more than 20% of German national GDP and population, and it is home to several of the country's most important companies. These include, for example, Deutsche Telekom and Deutsche Post (DHL Group); utilities E.ON, RWE, and Uniper; retail heavyweights Aldi and Rewe Group; steel producer Thyssen Krupp; and chemical giant Bayer. Consequently, we project a local GDP per capita for NRW of almost €49,000 (approximately $53,600) for 2025, only slightly below the forecast German national average of about €52,000 (approximately $57,300).

The anticipated recovery of operating margins and a contained deficit after capital accounts presuppose tax revenue growth and fiscal discipline

Our current base-case scenario continues to assume a gradual recovery of NRW's operating margins to above 5%. This reflects our recently updated view of improving economic growth in response to Germany's planned stimulus and infrastructure spending. Our projection incorporates the combined 11% salary rise over 2024 and 2025 from the last public sector wage agreement, and we assume annual rises of slightly above 3% thereafter. Moreover, we expect NRW can reduce the growth in operating transfers to below the rate assumed in its latest, but now outdated, medium-term financial plan from mid-2024. If this does not materialize, results could be decisively weaker. That said, the revised deficit ceiling in Germany's constitution gives NRW more capacity to absorb recent adverse developments and permits the modest deficits that we project for the outer years of our 2025-2028 forecast horizon. Similar to 2024, NRW can in 2025 again use the business cycle-based exemption from the debt brake's ordinary deficit limit to justify temporarily more elevated deficits after capital accounts.

Pension and related payments under the state's pay-as-you-go system for civil servants continue to reduce budgetary leeway for NRW. They currently consume above 12% of annual adjusted operating revenue and are predicted to continue rising, particularly health care-related payments. While we understand that NRW's dedicated pension reserve account amounted to almost €16 billion as of year-end 2024, these funds actually cover less than 18 months of pension cost. Hence, they can only mitigate NRW's pension burden, but by no means fully finance it. NRW has changed its policy and replaced contributions with annual withdrawals from the reserve account, which are planned to always correspond to the profits made two years prior. Accordingly, asset growth will now be limited to pension contributions paid by third parties for employees NRW regularly sends to work for other organizations, e.g., federal government, international organizations, foreign universities, etc. The receiving institutions need to reimburse NRW for the salary of the seconded individuals, but also need to pay a contribution into NRW's reserve account for future civil servant pensions. And while NRW does not put money aside for its current employees, it still receives such payments for employees "on loan" to other organizations.

We consider NRW's tax-supported debt burden of about 180% of consolidated operating revenue to be very high in an international comparison, especially when contingent liability risk is considered. However, the state benefits from sophisticated debt management. It is an established capital market issuer and is active in various funding currencies, although always on a fully euro-hedged basis. NRW maintains a predominantly fixed-rate debt portfolio, with residual variable rate exposure largely matched by short-term assets. The portfolio has an average maturity of above 19 years. Since 2023, derivative-based rate hedges are employed to help prevent a sudden increase in interest cost. To calculate our tax-supported debt metric, we add the financial liabilities of the state's real estate manager Bau- und Liegenschaftsbetrieb NRW and a school investment program prefinanced by promotional lender NRW.Bank to the core budget's direct debt. The decline in outstanding debt volume in 2024, despite deficits, reflects the use of existing liquidity to redeem pandemic- and energy crisis-related borrowings. While this will be repeated in 2025, the effect on debt will be more than offset by the planned assumption of legacy short-term loans ("Kassenkredite") from fiscally weaker municipalities. Based on the budget allocation for related interest payments, we estimate that about €8 billion of such debt could be transferred onto the state's balance sheet over the next years. This transfer will commence already in 2025, and thereby earlier than previously planned.

We think that contingent liability risk arises primarily from active and legacy financial institutions, and--even after the planned debt assumption--the municipal sector. That said, Erste Abwicklungsantalt and Portigon, which both manage the orderly wind-down of former state bank WestLB, have now reduced materially in size. This leaves state promotional lender NRW.Bank as a very large, albeit well-capitalized, financial sector participation.

NRW's cash balance of almost €13 billion held at the beginning of 2024, although predicted to decline, and securities worth almost €16 billion at year-end 2024 in its pension reserve account more than fully cover this year's debt service. Together with the state's proven borrowing ability in the capital market and its access to liquidity from other levels of government, we assess NRW's liquidity position as exceptionally strong. The state does not maintain any committed bank credit facilities.

Key Statistics

Table 1

State of North Rhine-Westphalia--Selected indicators

	--Fiscal year end Dec. 31--					
Mil. €	**2023**	**2024**	**2025bc**	**2026bc**	**2027bc**	**2028bc**
Operating revenues	92,934	95,084	97,020	99,958	103,152	106,842
Operating expenditures	87,945	90,612	93,856	95,545	97,836	100,431
Operating balance	4,989	4,472	3,164	4,413	5,316	6,411
Operating balance (% of operating revenues)	5.4	4.7	3.3	4.4	5.2	6.0
Capital revenues	2,013	2,948	3,609	4,331	4,336	4,238
Capital expenditures	10,404	9,973	10,773	12,337	12,495	12,705
Balance after capital accounts	(3,402)	(2,553)	(4,000)	(3,593)	(2,843)	(2,056)
Balance after capital accounts (% of total revenues)	(3.6)	(2.6)	(4.0)	(3.4)	(2.6)	(1.9)
Debt repaid	15,142	14,435	14,807	11,258	11,534	10,623
Gross borrowings	15,782	12,462	14,090	15,883	14,447	12,679
Balance after borrowings	(2,536)	(4,725)	(4,919)	830	(132)	(202)
Direct debt (outstanding at year-end)	166,135	164,162	171,445	176,070	178,983	181,039
Direct debt (% of operating revenues)	178.8	172.6	176.7	176.1	173.5	169.4
Tax-supported debt (outstanding at year-end)	172,565	170,465	177,675	182,200	185,013	186,969
Tax-supported debt (% of consolidated operating revenues)	185.7	179.3	183.1	182.3	179.4	175.0
Interest (% of operating revenues)	3.1	3.7	3.8	3.9	3.9	3.9
Local GDP per capita (€)	46,194	47,323	48,877	50,446	52,049	N/A
National GDP per capita (€)	49,616	50,947	52,170	53,689	55,211	56,776

The data and ratios above result in part from S&P Global Ratings' own calculations, drawing on national as well as international sources, reflecting S&P Global Ratings' independent view on the timeliness, coverage, accuracy, credibility, and usability of available information. The main sources are the financial statements and budgets, as provided by the issuer. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N/A--Not applicable.

Ratings Score Snapshot

Table 2

State of North-Rhine Westphalia--Ratings score snapshot

Key rating factors	Score
Institutional framework	1
Economy	1
Financial management	2

Table 2

State of North-Rhine Westphalia--Ratings score snapshot (cont.)

Key rating factors	Score
Budgetary perfomance	3
Liquidity	1
Debt burden	5
Stand-alone credit profile	aa
Issuer credit rating	AA

S&P Global Ratings bases its ratings on non-U.S. local and regional governments (LRGs) on the six main rating factors in this table. In the "Methodology For Rating Local And Regional Governments Outside Of The U.S.," published on July 15, 2019, we explain the steps we follow to derive the global scale foreign currency rating on each LRG. The institutional framework is assessed on a six-point scale: 1 is the strongest and 6 the weakest score. Our assessments of economy, financial management, budgetary performance, liquidity, and debt burden are on a five-point scale, with 1 being the strongest score and 5 the weakest.

Key Sovereign Statistics

- Sovereign Risk Indicators, April 10, 2025. An interactive version is available at http://www.spratings.com/sri

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Methodology For Rating Local And Regional Governments Outside Of The U.S., July 15, 2019
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Economic Outlook Eurozone Q2 2025: A World In Limbo, March 25, 2025
- Proposed Easing Of The Debt Brake Leaves German States To Chart Their Own Fiscal Paths, March 6, 2025
- Sovereign Brief: What The End Of The Debt Brake Means For Germany's 'AAA' Rating, March 6, 2025
- Full Analysis: NRW.Bank, Feb. 19, 2025
- Credit FAQ: Implications Of The Debt Brake And Its Potential Loosening For Our Ratings On German States, Feb. 17, 2025
- Germany 'AAA/A-1+' Ratings Affirmed; Outlook Stable, Jan. 31, 2025
- Local And Regional Government Outlook 2025: Weak German Growth Will Require New Borrowing, Jan. 16, 2025

- NRW.BANK And Erste Abwicklungsanstalt Outlooks Revised To Negative On Similar Action On NRW; 'AA/A-1+' Ratings Affirmed, Oct. 29, 2024
- Full Analysis: Erste Abwicklungsanstalt, Sept. 10, 2024
- Institutional Framework Assessment: New Challenges Could Test German States' Commitment To Balanced Budget Rules, May 25, 2023

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts.

The committee's assessment of the key rating factors is reflected in the Ratings Score Snapshot above.

The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook. The weighting of all rating factors is described in the methodology used in this rating action (see 'Related Criteria And Research').

Ratings List

Ratings Affirmed	
North Rhine-Westphalia (State of)	
Issuer Credit Rating	AA/Negative/A-1+
Senior Unsecured	AA