German State of Hesse 'AA+/A-1+' Ratings Affirmed; Outlook Stable

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Overview

- The expected recovery in economic growth, alongside management's cost-containment measures, will see the State of Hesse's operating margin improve.
- At the same time, we expect Hesse to make use of recent debt-brake easing decisions to finance its investment program, which will lead to moderate structural deficits after capital accounts.
- The state will continue to benefit from excellent access to capital markets if needed and manage its debt and liquidity prudently.
- We therefore affirmed our 'AA+/A-1+' ratings on Hesse. The outlook remains stable.

Rating Action

On April 11, 2025, S&P Global Ratings affirmed its 'AA+/A-1+' long- and short-term issuer credit ratings on the German State of Hesse. The outlook is stable.

Outlook

The stable outlook reflects our view that Hesse will leverage a likely nationwide economic recovery and simultaneous cost control measures to improve budgetary performance. This is despite our assumption that the state will make use of the recent decision to ease debt-brake rules and allow it to post structural-but-limited deficits after capital accounts. It also reflects our view of Hesse's excellent access to external liquidity for long- and short-term financing.

Downside scenario

We could lower our ratings on Hesse if management failed to contain expenditure growth or tax revenue recovery is substantially less pronounced than we exepct. In this case, we would expect the state's budgetary performance to deteriorate, which would require additional need for debt financing. This could also lead to a reassessment of Hesse's management.

Upside scenario

We could raise the ratings on the state if cost savings lead to structural surpluses after capital expenditure, which would allow Hesse to reduce its debt more significantly than we expect.

Rationale

An expected pickup in national and regional GDP growth in 2026 and beyond will lead to higher tax revenue for Hesse. Together with our expectation that the state's management will contain operating cost pressure, we think the state's operating balance will recover to levels of about 5% of operating revenue. We incorporate in our analysis the two main features for German states under the recent easing of debt-brake restrictions. We think Hesse's share of the infrastructure package is largely neutral for its budgetary performance, based on incoming revenue being approximately equal to additional spending. However, we expect the state will, if necessary, make use of the easing to raise up to 0.35% of local GDP in structural new debt. Although Hesse's cash levels remain low in an international comparison, we think the state will have no problem refinancing its maturing debt given its uninterrupted access to deep capital markets and bank financing, as well as Germany's short-term interstate liquidity support mechanism.

In our view, management will leverage cost pressure easing and tax revenue growth to balance budgets

We recently revised upward our national economic growth forecasts, which now includes effects from the announced national infrastructure and military spending (see "Economic Outlook Eurozone Q2 2025: A World In Limbo," published March 25, 2025, on RatingsDirect), notwithstanding developments regarding tariffs since April 1. We continue to expect Hesse's economy to move broadly in line with the German national average. The state continues to benefit from a strong and diversified economy, which is dominated by the services sector (about 75% of gross value added), with a strong pharmaceuticals sector and high exposure to finance and transport. The state's economy is resilient due to its mix of services and manufacturing but remains somewhat exposed to global trade and supply-chain risks through its export-oriented companies.

The institutional framework under which German states operate is one of the most predictable and supportive among the public finance systems we evaluate. Together with Bavaria and Baden-Wuerttemberg, Hesse is a major net contributor to the federal government's tax-equalization system, which facilitates almost-equal per capita revenue for all German states, shielding states' budgets from significant impacts on local economies. On March 21, 2025, a law passed the second chamber of government that will see the federal government providing €100 billion for infrastructure, spread over 10 years, to the states. At the same time, the law grants German states an annual structural net borrowing of up to 0.35% of GDP, rather than requiring them to fully balance their budgets as is the case now (see "Proposed Easing Of The Debt Brake Leaves German States To Chart Their Own Fiscal Paths," published March 6, 2025). We view the discussions on this law and the recognition of states' needs at the federal level as generally supportive of our framework assessment.

Hesse's financial management will remain a credit strength, in our view. While we think the state will make use of its new ability to run structural deficits of up to 0.35% of GDP, we do not think it will significantly increase operating expenditure because of this. On the contrary, after increasing its personnel costs in recent years, to preempt a potential court ruling against it, we think management will contain Hesse's operating expenditure growth. At the same time, we assume the state will use the deficit allowance to finance additional capital expenditure, which will lead to small deficits after capital accounts over our forecast horizon. We further expect Hesse to make full use its share of the infrastructure fund, which will likely amount to about €750 million, although the final split is not publicly known yet. We assume this share will increase capital revenue and expenditure equally, making it balance neutral. Should Hesse's tax revenue grow faster than we anticipate, we would not expect the state to meaningfully increase spending; instead, it is likely to continue or accelerate its debt repayment. Hesse displays a high standard of debt and liquidity management by actively managing its debt portfolio. The state has fixed interest rates on some debt maturities and substantially extended the average duration of its debt portfolio. These measures increase the predictability of interest payments.

Recovering tax revenue growth will help in budgetary recovery despite higher investments

Under our revised assumptions for real GDP growth in Germany, following the announcement of large infrastructure and military investments and despite some risk from recent developments regarding tariffs, we expect tax revenue growth to aid Hesse's management in balancing its increased operating expenditure levels. This is despite census results from 2024 leading to Hesse's tax revenue allocation being lowered. We think management has prudently addressed a likely ruling by the federal constitutional court by increasing personnel cost in recent years to levels above those required by the current collective bargaining agreement. With these developments largely finalized, we view Hesse as well prepared to limit operating expenditure growth. Combined, these effects will lead to operating budgetary performance to return to levels close to or above 5% of operating revenue in the outer years of our forecast horizon.

However, we understand Hesse will likely make use of its structural debt allowance under the easing of debt brake rules to finance capital expenditure, if necessary. This will lead to moderate, but likely more structural than previously assumed, deficits after capital accounts. In this regard, we view the share of investment allocated to Hesse under the national infrastructure fund--most likely about €750 million--as neutral to its budgetary performance. We think the state will adhere to the agreement for additionality of these investments--in which new investments need to be on top of, not crowding out, normally planned investments--and therefore balance all revenue with corresponding added expenditure. While we think small crowding-out effects are possible, we do not include these assumptions in our analysis.

These deficits after capital accounts will lead to Hesse's tax-supported debt to remain very high in an international comparison. We had previously assumed that stable nominal debt figures would lead to the state's relative indebtedness (as a share of total consolidated revenue) to go down, but we now view this development as somewhat slower than expected. Hesse's one-time €2 billion cash capital injection into commercial bank Helaba in 2024, which was fully debt-financed, brought its debt up to 151% of consolidated operating revenue, although this was still lower than the 158% of 2021. We now forecast the state's debt burden to decline toward 138% of consolidated operating revenue in 2027. Our tax-supported debt figure includes direct debt, capitalized long-term rent obligations (from three sale-and-rent-back transactions), and committed debt repayments for the two municipal support programs. In our view, Hesse's contingent liabilities are low in a national comparison. They contain various risks from the state's stake in Helaba, including WI-Bank, in which Hesse now has a 30% stake; debt in its participations; and other guarantees outstanding.

We view Hesse's liquidity as very strong in an international comparison. The change in liquidity strategy from historically negative to balanced cash and view the positive effect it has on debt-service coverage supports our liquidity assessment. Our calculation of the state's debt-service coverage over the next 12 months includes cash holdings and issued debt for the current year, but not the amount accumulated in the pension fund, or the special assets earmarked for housing and municipality investment support.

We also continue to include in our assessment Hesse's exceptional access to external liquidity. In our view, the state has uninterrupted access to deep capital markets and bank financing, as well as to Germany's interstate short-term liquidity support mechanism, which we view as a key credit strength. Hesse has demonstrated its ability to access markets at extremely favorable conditions, for example during the pandemic 2020-2021 when it ramped up funding activities. It finances collateral deposits, currently totaling about €1.5 billion, using its own funds. These deposits are restricted and not accessible for debt-servicing. In 2023, Hesse issued its second green bond of a benchmark size compared with that of German states, which garnered substantial investor interest, and we expect the state to use this option again in 2025.

Key Statistics

Table 1

State of Hesse--Selected indicators

	--Year ended Dec. 31--					
(Mil. €)	**2022**	**2023**	**2024**	**2025bc**	**2026bc**	**2027bc**
Operating revenues	34,633	32,970	34,281	35,821	37,163	38,552
Operating expenditures	31,380	31,965	34,004	34,966	35,857	36,588
Operating balance	3,253	1,006	277	855	1,306	1,964
Operating balance (% of operating revenues)	9.4	3.1	0.8	2.4	3.5	5.1
Capital revenues	819	1,081	936	1,562	1,693	1,707
Capital expenditures	2,211	2,650	4,733	3,301	3,738	3,860
Balance after capital accounts	1,860	(563)	(3,520)	(884)	(739)	(189)
Balance after capital accounts (% of total revenues)	5.2	(1.7)	(10.0)	(2.4)	(1.9)	(0.5)
Debt repaid	8,749	7,666	7,424	6,385	5,091	5,857
Gross borrowings	3,630	9,073	10,776	8,055	5,876	6,227
Balance after borrowings	(3,377)	728	(262)	668	(72)	63
Direct debt (outstanding at year-end)	47,707	48,867	51,730	52,912	53,210	53,091
Direct debt (% of operating revenues)	137.8	148.2	150.9	147.7	143.2	137.7
Tax-supported debt (outstanding at year-end)	47,707	48,867	51,730	52,912	53,210	53,091
Tax-supported debt (% of consolidated operating revenues)	137.8	148.2	150.9	147.7	143.2	137.7
Interest (% of operating revenues)	2.2	2.3	2.6	3.0	3.5	3.8
Local GDP per capita (€)	51,368	54,806	56,067	57,653	59,366	61,117

Table 1

State of Hesse--Selected indicators (cont.)

	--Year ended Dec. 31--					
(Mil. €)	2022	2023	2024	2025bc	2026bc	2027bc
National GDP per capita (€)	47,501	50,356	51,587	52,723	54,457	56,407

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. N.A.--Not available. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

State of Hesse--Ratings score snapshot

Key rating factors	Scores
Institutional framework	1
Economy	1
Financial management	1
Budgetary performance	3
Liquidity	1
Debt burden	4
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 our "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. Interactive version 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
- Sovereign Brief: What The End Of The Debt Brake Means For Germany's 'AAA' Rating, March 6, 2025
- Bulletin: Proposed Easing Of The Debt Brake Leaves German States To Chart Their Own Fiscal Paths, March 6, 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
- Subnational Government Outlook 2025: Borrowings Are Still On The Rise, Jan. 16, 2025
- Local And Regional Government Outlook 2025: Weak German Growth Will Require New Borrowing, Jan. 16, 2025
- Global LRGs Rating History List, June 17, 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	
Hesse (State of)	
Issuer Credit Rating	AA+/Stable/A-1+
Senior Unsecured	AA+
Short-Term Debt	A-1+